



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^[la1]

QUESTION 1^[la2](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^[la3]

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^[la4]

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.*
- 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^[1a5]

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^[1a6]

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^[1a7]

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^[1a8]

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^[1a9]

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^[1a10]

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^[1a11]

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^[1a12]

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 [la13](direct questions) [10 marks]

Question 2.1 [la14] (1 mark)

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

Setoff allows a creditor to net out claims against a debtor against any monies owing to the debtor. [la15] This is not permitted in many circumstances as it may potentially improve the position of that creditor compared to other unsecured creditors [la16] (similar to a preference), by reducing the obligation to the debtor by the full amount owed, rather than the lesser amount that the debtor would pay on the unsecured claim (in a Chapter 7 of Chapter 11).

Question 2.2 [la17][2 marks]

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

When preparing a filing for a bankruptcy court, you should review and have regard to:

- *The Bankruptcy Rules; [la18]*
- *The Federal Rules of Civil Procedure [la19]; and*
- *Local rules [la20] of the bankruptcy court.*

Question 2.3 [la21] [2 marks]

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

The absolute priority rule provides that a creditor/class of creditor can receive no worse treatment under a chapter 11 plan of reorganization than they would have received under a chapter 7 liquidation, without their consent. [la22]

This rule can be deviated from in specific circumstances, [la23] such as when a senior creditor consents to receiving less to allow higher distribution to lower ranking creditors [la24] to obtain approval of the reorganization plan.

Question 2.4 [la25] [2 marks]

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

A priming lien is a lien that is senior or equal to pre-petition lien(s) on estate property [la26], to allow for the estate to secure post-petition financing.

In order for a priming lien to be granted by the court, the debtor must be able to demonstrate that it has not been able to raise DIP financing through unsecured

creditor or secured debt without priming^[la27], and that the interests of the secured creditor(s) being primed is being adequately protected^[la28].

Question 2.5^[la29] [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?

A preference is a transfer of debtor property made shortly prior to the filing of a bankruptcy petition, that (subject to a number of potential defences available to the creditor), must be returned to the bankrupt estate if the amount transferred exceeds the amount that the creditor would have received in a chapter 7 liquidation in lieu of that transfer.^[la30]

To prove a preference, it must be established that a transfer of an interest of the debtor in property^[la31] was made (including the granting of a lien), that the transfer was to or for the benefit of a creditor^[la32], and that the transfer was made for or on account of an antecedent debt^[la33] owed by the debtor before the transfer was made. The transfer must have been made whilst the debtor was insolvent, and during the suspect period. Finally, the creditor must have received more from the transfer than it would have in chapter 7, in lieu of the transfer.

There is no need to show fault by either debtor or creditor to establish a preference^[la34].

QUESTION 3^[la35] (essay-type questions) [15 marks in total]

Question 3.1^[la36] [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?

Bankruptcy judges have limited jurisdiction to enter final orders other than on core bankruptcy issues. Particularly, a bankruptcy court cannot issue final orders that invade Article II jurisdiction, even in core proceedings^[la37].

Generally, appeals arising from a bankruptcy court is heard by the district court^[la38] for the district in which the bankruptcy court sits, or in certain circuits, the Bankruptcy Appellate Court^[la39].

In orders of noncore proceedings or non-final orders, the appellate court reviews de novo all findings of fact and conclusions of law to which a party has objected^[la40].

Question 3.2^[la41] [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?

Upon petition for recognition of a foreign main proceedings being granted, the stay of creditor action [la42] applies to the debtor's property within the territorial jurisdiction of the United States. Other discretionary relief that may also be granted includes:

- Operation of the debtor's business in the ordinary course by the foreign representative [la43];
- Sale, transfer or use of property outside the ordinary course [la44];
- Avoidance of post-petition transfers / perfection of security interests.

Discretionary relief may also be granted for either foreign main or non-main proceedings including:

- Authorization of discovery regarding debtors assets and affairs [la45];
- Entrusting debtor assets to the foreign representative or other person [la46];
- Extension of provisional relief [la47];
- Any other relief necessary to protect the assets and interests of creditors.

Question 3.3 [la48] [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?

In a Delaware corporation, directors owe a fiduciary duty to the corporations best interests [la49] and a duty of care [la50] in educated decision-making. Directors' duties in Delaware are owed to the corporation and its shareholders, not to creditors, including in circumstances where the corporation is insolvent. [la51] There is no equivalent to wrongful trading under US law.

Directors are protected from liability for errors of judgement by the business judgement rule [la52], under which they are presumed to have acted in good faith on the basis of reasonable information. The rule is subject to rebuttal by showing that a majority of the board were not reasonably informed, did not honestly believe the decision was in the corporation's best interests, or were not acting in good faith.

Question 3.4 [la53] [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 in an involuntary proceeding, the creditor must have a claim against a debtor that is:

- **Non-contingent** [la54], in that it does not depend on the occurrence of a future event, [la55] or if in the instance of an unmatured debt, if all requirements for liability have occurred other than the passage of time.
- **Not the subject of a bona fide dispute as to liability or amount** [la56]. A bona fide dispute exists if there is an objectively reasonable basis for the dispute as a matter of fact or law [la57].
- **Unsecured or undersecured** [la58] (individually, or in aggregate with other petitioning creditor claims) in the amount of at least **US 16.750** [la59] (subject to indexing for inflation).

QUESTION 4 [la60] (fact-based application-type question) [15 marks in total]

Question 4.1 [la61] [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?

- The DOJ investigation does not violate** [la62] **the automatic stay** [la63] (as it is a regulatory investigation and/or criminal proceeding, which are both statutory exceptions) and may be continued.
- The margin loan default is caught by the automatic stay** [la64]. The margin loan contract is an executory contract, however, taking into consideration that the contract is one to make a loan/financial accommodation, the broker's consent is required to assume the margin loan contract. In the event that consent is provided, the default needs to be cured.
- The rental arrears is subject to the automatic stay.** [la65] The delinquent lease is also an executory contract, however, subject to being cured of default, may be assumed by the debtor/trustee and/or assigned in a 363 sale.
- The employment discrimination lawsuit is subject to the automatic stay** [la66], however, based on the circumstances, a court may grant relief for the lawsuit to continue.

Question 4.2^[1a67] [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?

The English scheme of arrangement can be recognized by a US bankruptcy court under Chapter 15, taking into consideration that the requirement of recognition is broadly that a foreign proceeding with respect to the debtor is pending, and that the foreign representative is empowered to act by the proceeding.

The Bankruptcy Code defines foreign proceedings as “a collective judicial or administrative proceeding in a foreign country...under a law relating to insolvency or adjustment of debt in which proceeding the assets and affairs of the debtor are subject to control or supervision by a foreign court, for the purpose of reorganization or liquidation. Such definition is broad enough to include English schemes.

Based on the information provided, the Scheme may be recognized as a foreign main proceeding, with reference to its COMI. Whilst Stella is incorporated in France, its debt funding is all governed by English law. Further information is required (such as location of headquarters, management, primary assets, etc) to provide a more certain opinion on Stella’s COMI.^[1a68]

Question 4.3^[1a69] [5 marks]

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

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

The license is an executory contract, as there are material unperformed obligations with respect to both parties (i.e. GameMart’s obligation to pay monthly royalties to ToyCo, and ToyCo’s obligation to provide exclusive manufacturing rights to GameMart).^[1a70]

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

Based on the given information, GameMart cannot transfer the Xbox license as part of a 363 sale without ToyCo's consent,^[la71] taking into consideration that substantive non-bankruptcy law issues are involved. Pursuant to the relevant intellectual property licensing law, ToyCo cannot be compelled to accept performance from a transferee without consent^[la72].

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

GameMart can assume and assign the factory lease as part of a 363 sale without Land Corp's consent^[la73], notwithstanding that the lease purports to prohibit assignment without the landlord's consent. This is because the factory lease is an executory contract, and the Bankruptcy Code abrogates such contractual restrictions on assignment to third parties^[la74].

* End of Assessment *