



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

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

Commented [la2]: Total marks 7/10

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 [la3]: 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 [la4]: 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

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.*

Commented [la5]: Incorrect, the correct response is (a). The software license is subject to copyright so consent should be required.

Question 1.4

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.*

Commented [la6]: Incorrect, the correct response is (b)

Question 1.5

Which of the following about cramdowns, is false?

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- (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 [la8]: 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

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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

Commented [la10]: Correct, 1 mark

When does an automatic stay come into effect?

- (a) Immediately on the filing of any plenary petition.
- (b) On the filing of a voluntary petition but not on the filing of an involuntary petition.
- (c) Once the court reviews the petition and grants the stay.
- (d) Once the petitioner announces their intention to file for bankruptcy publicly.
- (e) Once a plan of reorganization is confirmed.

Question 1.9

Commented [la11]: Correct, 1 mark

Which of the following regarding substantive consolidation is true?

- (a) It respects the boundaries of corporate separateness.
- (b) It is the treatment of two or more creditors as a single creditor to simplify the claims process.
- (c) If a creditor can show it extended credit on the basis of corporate separateness, it has a valid objection to substantive consolidation.
- (d) Substantive consolidation is commonly used to resolve bankruptcies of corporate groups.
- (e) Authority for substantive consolidation comes from the Bankruptcy Code.

Question 1.10

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

- (a) The location of the headquarters.
- (b) The location of primary assets.
- (c) The location of the majority of the affected creditors in the request for relief.
- (d) The jurisdiction whose law will apply to most disputes.
- (e) All of the above.

QUESTION 2 (direct questions) [10 marks]

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Question 2.1 (1 mark)

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

Setoff, also known as "offset," is a legal right that allows parties to net mutual debts and credits between each other, resulting in the reduction or elimination of the amount owed. In simple terms, if two parties owe each other money, they can offset their respective debts, and the party owing a larger amount can pay the difference to the other party. For example, if Company A owes \$5,000 to Company B, and Company B owes \$3,000 to Company A, they can offset these amounts, and Company A will only need to pay \$2,000 to Company B (\$5,000 - \$3,000). Setoff is beneficial because it simplifies the payment process, avoids unnecessary transfers of funds, and reduces administrative burdens for both parties involved. It is commonly used in various commercial transactions, contracts, and financial dealings. However, setoff is not permitted in many circumstances due to the potential for abuse and unfairness. Some reasons why setoff may not be allowed include: (i) preventing preferential treatment; (ii) timing restrictions (within 90 days); and (iii) potential contractual restrictions explicitly prohibiting setoff.

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Commented [la16]: Correct, 1/2 mark

Question 2.2 [2 marks]

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

At the very least, the Bankruptcy Rules, the Federal Rules of Civil Procedure, the local rules of the bankruptcy court, and the judge's personal practices. If you are not qualified and regulated in a jurisdiction, instructing a local practitioner, both for advice on unwritten local practices, and for your own insurance purposes, is sensible.

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Question 2.3 [2 marks]

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

The absolute priority rule governs the order of payment to creditors and equity holders during a Chapter 11 reorganization or individual Chapter 7 liquidation. It requires that creditors with higher priority claims must be paid in full before any distribution is made to creditors with lower priority claims or to equity holders.

Commented [la23]: Correct, 1 mark, the absolute priority rule can be deviated from in a chapter 11 plan with the consent of the affected creditors (the senior creditors who are getting less than full payment)

In a Chapter 11 bankruptcy, the absolute priority rule applies to the approval of a reorganization plan. The plan must be accepted by each impaired class of creditors (creditors whose rights are affected by the plan) unless the plan satisfies the "absolute priority rule." According to the rule, if any class of impaired creditors rejects the plan, equity holders (such as shareholders) are not entitled to retain any property under the plan unless:

1. All creditors in the higher-ranking class (creditors with claims of equal or higher priority) are paid in full; or

2. Equity holders contribute "new value" to the reorganized company, and the plan does not unfairly discriminate against any class of creditors.

The absolute priority rule aims to ensure fair treatment of creditors and equity holders during the bankruptcy process. It prevents equity holders from retaining ownership or receiving distributions without contributing new value if creditors are not paid in full. This helps protect the interests of creditors and prevents shareholders from receiving a windfall at the expense of unpaid creditors.

However, the absolute priority rule can be deviated from under specific circumstances, including:

1. Cramdown. If a plan is "crammed down" (confirmed over the objection of one or more impaired classes of creditors), it can deviate from the absolute priority rule. To be confirmed, the plan must still be fair and equitable and not unfairly discriminate against any impaired class. The court must find that the plan meets these criteria, even if equity holders do not contribute new value.

2. New value exception. Equity holders can retain ownership without contributing new value if they provide "new value" to the reorganized company. New value can be in the form of additional capital or new investments that are reasonably equivalent to the value of their existing ownership interests.

3. Consent of impaired classes. If all impaired classes of creditors accept the plan, the absolute priority rule does not apply, and equity holders may retain their ownership without contributing new value.

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?

(1) A "priming lien" is a type of security interest or lien that takes priority over existing liens or claims on a debtor's assets. It allows a lender providing debtor-in-possession (DIP) financing in a bankruptcy case to obtain a superior position, ahead of other creditors, in terms of repayment priority. Priming liens are essential in encouraging lenders to extend credit to financially distressed companies during bankruptcy, as they provide the lender with increased protection and better chances of repayment.

(2) To obtain a priming lien and secure DIP financing, certain requirements must be met:

(a) Court approval. The debtor must seek approval from the bankruptcy court to incur the DIP financing and grant the priming lien. The court will consider whether the financing is necessary for the debtor's reorganization efforts and whether it is in the best interest of the estate.

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Commented [la26]: The court must be satisfied that DIP financing is not available absent the priming lien

(b) Adequate protection. **Existing lienholders and creditors must be given "adequate protection" to compensate for any diminution in the value of their collateral due to the priming lien. This ensures that the interests of the existing creditors are not unfairly prejudiced.**

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(c) Fair and equitable terms. **The terms of the DIP financing, including interest rates, fees, and repayment terms, must be fair and equitable. The court will assess whether the financing is reasonable and does not burden the debtor with excessive costs.**

(d) Good faith. **The debtor must act in good faith when seeking the DIP financing and the priming lien. The court will examine whether the debtor's decision to incur the financing and grant the priming lien is a legitimate attempt to reorganize and continue business operations.**

Question 2.5 [3 marks]

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What is a preference? What are the elements of a preference claim that need to be proved? Is a showing of fault, by either the debtor or creditor, required?

1. A preference refers to a payment or transfer made by a debtor to a creditor within a certain period before filing for bankruptcy that gives the creditor an advantage over other creditors. **The purpose of bankruptcy preference law is to prevent certain creditors from receiving preferential treatment over others before the debtor enters bankruptcy.**

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2. To establish a preference claim, the following elements need to be proved:

- Transfer to a creditor. **There must be a transfer of the debtor's property, such as money, goods, or assets, made to a creditor.**
- Made for an antecedent debt. **The transfer must have been made to pay off an existing debt that arose before the transfer was made. The debt is considered "antecedent" to the transfer.**
- Made within the preference period. **The transfer must have been made within a specific period before the debtor filed for bankruptcy. In most cases, this period is 90 days for ordinary creditors and one year for insiders (such as relatives, insiders, or affiliates of the debtor).**
- Creditor received more than in a chapter 7 liquidation. **The transfer must have allowed the creditor to receive more than it would have received if the debtor had filed for Chapter 7 liquidation instead of reorganization. This means the creditor received a greater recovery compared to other creditors.**

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Commented [la31]: Correct, 1/2 mark

Commented [la32]: Correct, 1/2 mark

3. A showing of fault is not required to establish a preference claim. **Preference law is designed to be objective and encourage the fair and equitable distribution of the debtor's assets among all creditors. The focus is on the effect of the transfer and whether it results in unequal treatment of creditors. Thus, a**

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preference claim can be brought even if there was no intent to prefer the creditor, as long as the elements of the preference are met. This helps prevent the debtor from manipulating payments to certain creditors before filing for bankruptcy and ensures a more even distribution of assets among all creditors.

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

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Question 3.1 [3 marks]

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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?

Circumstances in which a bankruptcy court may enter a final order. **A bankruptcy court may enter a final order when it dispose of all issues, leaving nothing further to be decided, i.e. it resolves a substantive issue or disposes of a particular claim or cause of action within the bankruptcy case. Final orders are those that fully adjudicate the rights and liabilities of the parties involved and have a significant impact on the outcome of the case. Examples of final orders in bankruptcy include orders confirming a reorganization plan, granting or denying a discharge of debts, and orders dismissing the case.**

Commented [la36]: Correct, 1 mark, I was asking about constitutional finality, but these are also constitutionally final because they resolve issues created by the Bankruptcy Code

Who reviews appeals from bankruptcy court orders. **Appeals from bankruptcy court orders are generally reviewed by a higher court, specifically the federal district court in the same judicial district where the bankruptcy court is located. The district court serves as the appellate court for bankruptcy cases. The First, Sixth, Eighth, Ninth and Tenth Circuits however have elected, pursuant to 28 USC, § 158(b), to form Bankruptcy Appellate Panels, convened from the judges of the bankruptcy courts within the circuit.**

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How are non-final orders reviewed. **Non-final orders are orders that do not fully resolve the case or are considered interlocutory. In most cases, these are subject to review by the bankruptcy court itself upon a motion for reconsideration or clarification. If a party disagrees with a non-final order, they may file a motion asking the bankruptcy court to review and potentially modify or clarify the order. In some instances, if the bankruptcy court believes that an issue presented in a non-final order is complex or may significantly impact the case's outcome, it may certify the order for direct appeal to the district court. This certification process allows parties to seek immediate review of the non-final order by the district court, bypassing the need to file a motion for reconsideration before the bankruptcy court. (NB: recognizing the unique nature of bankruptcy proceedings as "an aggregation of individual controversies," the US Supreme Court has held (in *Bullard v Blue Hills Bank* 135 S Ct 1686 (2015) that a bankruptcy order resolving a discrete dispute is a final order for appeals purposes).**

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Commented [la39]: In general, motions for reconsideration are disfavored. Constitutionally non-final orders are reviewed as a report and recommendation / proposed findings of fact and law

Question 3.2 [3 marks]

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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?

Automatic relief. **Upon recognition of a foreign main proceeding under Chapter 15 of the United States Bankruptcy Code, several provisions of the Bankruptcy Code automatically apply to the debtor's property within the territorial jurisdiction of the United States. These provisions are known as "bankruptcy relief," and they include:**

- **Automatic stay. 11 USC, § 1520(a) says that 'Upon recognition of a foreign proceeding that is a foreign main proceeding— (1) sections 361 and 362 apply with respect to the debtor and the property of the debtor that is within the territorial jurisdiction of the United States; (2) sections 363, 549, and 552 apply to a transfer of an interest of the debtor in property that is within the territorial jurisdiction of the United States to the same extent that the sections would apply to property of an estate; (3) unless the court orders otherwise, the foreign representative may operate the debtor's business and may exercise the rights and powers of a trustee under and to the extent provided by sections 363 and 552; and (4) section 552 applies to property of the debtor that is within the territorial jurisdiction of the United States.'** This is subject to a carveout to permit the filing of a plenary US bankruptcy proceeding even after the recognition of a foreign proceeding. 11 USC, § 1520(c): *'Subsection (a) does not affect the right of a foreign representative or an entity to file a petition commencing a case under this title or the right of any party to file claims or take other proper actions in such a case.'*
- **Conducting the debtor's business as usual by the foreign representative.**
- **The disposition, transfer, or utilization of assets beyond ordinary business operations.**
- **Unwinding post-petition transfers and the establishment of security interests after the commencement of bankruptcy proceedings.**

Discretionary relief. **Following recognition of a foreign non-main proceeding, the discretionary grant of any of the relief above is possible. Furthermore, after recognition as either foreign main or foreign non-main, the discretionary grant of the following relief may also be granted:**

- **Authorization of discovery concerning the debtor's assets and affairs.**
- **Delegating management of the debtor's U.S. assets to the foreign representative or another party (though subject to 11 USC, § 1521(b), to safeguard U.S. creditors' interests adequately).**
- **Extension of provisional relief.**
- **Any additional necessary relief to accomplish the objectives of chapter 15 and safeguard the debtor's assets or creditors' interests (pursuant to 11 USC, § 1521(a)).**

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Commented [la42]: Correct, 1/2 mark

Commented [la43]: Correct, 1/2 mark

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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?

Duties owed in the ordinary course of business by directors to a Delaware corporation. **In the ordinary course of business, directors of a Delaware corporation owe fiduciary duties of care and loyalty to the corporation and its shareholders. These duties include (i) Duty of care. Directors must act with the level of care that a reasonably prudent person in a similar position would exercise under similar circumstances. They must make informed and reasonable decisions, act in good faith, and act in the best interests of the corporation; and (ii) Duty of Loyalty. Directors must act in the corporation's best interests and avoid any conflicts of interest. They must not engage in self-dealing, usurp corporate opportunities, or take actions that benefit their personal interests at the expense of the corporation.**

To whom those duties are owed when the corporation is potentially or actually insolvent. **The duties are owed to the corporation, not creditors, even if insolvency is possible or likely. The Delaware Supreme court held in *North Am Catholic Educational Programming Foundation, Inc v Gheewalla*, 930 A.2d 92, 103 (Del 2007) that ((Individual creditors of an insolvent corporation have no right to assert direct claims for breach of fiduciary duty against corporate directors. Creditors may nonetheless protect their interest by bringing derivative claims on behalf of the insolvent corporation...)). There is therefore no equivalent of the English rule in *West Mercia Safetywear Ltd v Dodd*[1988] BCLC 250, or the most recent restatement of that by the UK Supreme Court in *BTI 2014 LLV v Sequana SA* [2022] UKSC 25.**

The rule protecting directors from liability for errors of judgment. **To protect directors from liability for errors of judgment, the *business judgment rule* applies. The business judgment rule presumes that directors act in good faith, with due care, and in the best interests of the corporation. Under this rule, courts will not second-guess directors' decisions if they are informed, made in good faith, and free from conflicts of interest. Directors will generally be protected from personal liability for their decisions, even if those decisions turn out to be unsuccessful or result in financial losses for the corporation. However, the protection of the business judgment rule is not absolute. It can be overcome if there is evidence of gross negligence, bad faith, or self-dealing on the part of the directors. In such cases, directors may be held personally liable for their actions or decisions, especially if they breach their fiduciary duties of care and loyalty.**

Question 3.4 [5 marks]

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

To qualify as a petitioning creditor, the creditor's claim against the debtor must meet specific criteria:

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Commented [la48]: Correct, 1 mark

Commented [la49]: Correct, 1 mark

Commented [la50]: Partially correct, 1/2 mark, the duties remain also owed to the shareholders

Commented [la51]: Correct, 1 mark

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- The claim must be non-contingent, meaning it should not depend on the occurrence of a future event. For instance, a claim based on a guarantee is contingent upon a default under the guaranteed obligation. However, an unmatured debt (due in the future) is not considered contingent if all other liability requirements, except for the passage of time, have been met.
- The claim must not be the subject of a bona fide dispute regarding liability or the amount owed. A bona fide dispute exists when there is an objectively reasonable basis for disagreement, either factual or legal, regarding the debt. The debtor's subjective belief that the debt is not owed or the claimed amount is incorrect is insufficient to qualify as a bona fide dispute. If only a portion of the claimed amount is disputed, the creditor cannot include the undisputed portion to meet the monetary threshold required for petitioning creditor status. Nevertheless, a dispute on one claim does not disqualify other undisputed claims held by the same creditor to fulfil the petitioning creditor requirements.
- The claim must be unsecured or undersecured, either individually or when combined with other petitioning creditors' claims, in an amount equal to or exceeding USD 16,750 (subject to periodic adjustments due to inflation).

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Commented [la54]: Correct, 1/2 mark

Commented [la55]: Correct, 1 mark

Commented [la56]: Correct, 1/2 mark

Commented [la57]: Correct, 1 mark

Commented [la58]: Correct, 1/2 mark, the creditor must also allege that the debtor is failing to pay debts as they come due

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

Question 4.1 [5 marks]

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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?

(i) DOJ investigation. 11 U.S. Code § 362 (b) states that 'the filing of a petition [...] does not operate as a stay- (1) under subsection (a) of this section, of the commencement or continuation of a criminal action or proceeding against the debtor'. Criminal investigations and proceedings are therefore not halted by bankruptcy filings, so the DOJ can continue its investigation regardless of Speculation Inc's financial status. However, the bankruptcy process may complicate matters, and potential financial penalties resulting from the investigation could influence the bankruptcy proceedings.

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(ii) Margin loan default. **Upon filing for Chapter 11, an automatic stay goes into effect which stops most collection efforts against the debtor. This would halt the brokerage firm's efforts to collect on the margin loan default, at least temporarily. However, because the stocks purchased are held as collateral by the broker, the broker may have a secured claim in the bankruptcy case. How this would be resolved would depend on the specifics of the bankruptcy plan, the value of the collateral, and the balance of the loan.**

Commented [la62]: The margin loan is a securities contract exempt from the stay, so the broker can liquidate the collateral to apply to the loan balance.

Commented [la63]: Correct, 1 mark

(iii) Delinquent lease. **Similarly to the margin loan, the automatic stay would also halt the landlord's attempts to evict Speculation Inc for non-payment of rent. However, Chapter 11 bankruptcy law does have specific provisions for handling leases. Speculation Inc will have to decide whether to assume or reject the lease. If they choose to assume it, they would have to cure the default and provide adequate assurance of future performance. If they reject it, it would become an unsecured claim in the bankruptcy case, which may or may not be paid in full.**

Commented [la64]: Correct, 1 mark

(iv) Employment discrimination lawsuit. **The automatic stay would also halt the progress of this lawsuit, at least temporarily. The former employee would become a creditor in the bankruptcy case, with the claim likely treated as unsecured. The potential obligation to pay any judgment resulting from this lawsuit would be part of the Chapter 11 restructuring plan. The actual payment would depend on the plan's details and the amount of assets available for unsecured creditors.**

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Question 4.2 [5 marks]

Commented [la66]: Total marks 2/5

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

Chapter 15 of the United States Bankruptcy Code deals with cross-border insolvency cases and provides mechanisms for recognizing and cooperating with foreign bankruptcy proceedings. It is based on the Model Law on Cross-Border Insolvency developed by the United Nations Commission on International Trade Law (UNCITRAL).

The ability of a US bankruptcy court to recognize an English scheme of arrangement under Chapter 15 would depend on several factors, and the question has been a subject of some legal uncertainty. A scheme of arrangement under Part 26 of the (English) Companies Act 2006 is a process under which a company may enter into a compromise or arrangement with its members or creditors (or any class of them). In this case, this would include Stella's lenders and bondholders. While it is not technically an insolvency proceeding, a foreign proceeding is defined by the 11 U.S.

Code § 101(23) of the Bankruptcy Code 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' and so should be in scope.

The English scheme would be classified either as a foreign main proceeding or a foreign non-main proceeding based on where Stella has its "center of main interests" (COMI) or an "establishment." This would determine the scope of relief available in the US. COMI is a concept used in cross-border insolvency law to determine the jurisdiction in which a debtor's main insolvency proceedings should be opened. Generally, a debtor's COMI is the place where it conducts the administration of its interests on a regular basis and is therefore ascertainable by third parties.

An "establishment" is defined as any place of operations where the debtor carries out non-transitory economic activity. If Stella's COMI is determined to be in England (which may be difficult to establish given the company is incorporated and headquartered in France), then the scheme of arrangement could be recognized as a foreign main proceeding. If Stella's COMI is not in England, but the company has an "establishment" there, then the scheme of arrangement could be recognized as a foreign non-main proceeding.

However, it's important to note that these determinations are highly fact-specific and the ultimate decision would rest with the U.S. Bankruptcy Court. Also, while Chapter 15 does provide a mechanism for the recognition of foreign proceedings, such recognition is not automatic and may be subject to legal challenge.

Question 4.3 [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?

An "executory contract" in US bankruptcy law is generally understood to be a contract under which both sides still have important performance remaining. The Bankruptcy Code doesn't actually define "executory contract," but the most commonly used definition is called the "Countryman test" because it derives from an influential law review article by Professor Vern Countryman*. He defines it as a contract under which the obligation of both the bankrupt and the other party to the contract are so far unperformed that the failure of either to complete performance would constitute a

Commented [la67]: Partially correct, 1.5/2 mark, that would be difficult to establish on these facts because the headquarters are in the jurisdiction of incorporation and so the presumption would not be rebutted.

Commented [la68]: Partially correct, 1/2 mark, here there is a retail store in England so the establishment requirement is met

Commented [la69]: Total marks 2/5

material breach excusing performance of the other. Given that GameMart has an ongoing obligation to manufacture the toys and pay royalties to ToyCo, and ToyCo has a continuing obligation to permit GameMart to use its patents, it is likely that the license would be considered an executory contract.

Commented [la70]: Correct, 1 mark

* Countryman, "Executory Contracts in Bankruptcy: Part 1," 57 Minn. L. Rev. 439, 450 (1973)

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

Section 365(c) of the Bankruptcy Code prohibits the assignment of an executory contract if "applicable law" excuses the counterparty (here, ToyCo) from accepting performance from an assignee, whether or not the contract prohibits assignment. Applicable law typically includes non-bankruptcy law, like contract law, and in many cases intellectual property law restricts the assignment of patent licenses without the licensor's consent. This is an area of law with some complexities and contradictions, and courts have interpreted these provisions in different ways, but generally, without ToyCo's consent, transferring the license could be problematic.

Commented [la71]: Correct, 1 mark, consent would be required under intellectual property law

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

In a Section 363 sale, the debtor-in-possession or trustee may sell property of the estate free and clear of any interest in such property, provided certain conditions are met. With regards to the factory lease, however, Section 365 of the Bankruptcy Code, which addresses the assumption and assignment of executory contracts and unexpired leases, provides that a lease may not be assigned without the lessor's consent if it contains a clause that prohibits, restricts, or conditions assignment. Therefore, unless Land Corp consents or the lease can be assumed and assigned under other applicable law (for example, by providing adequate assurance of future performance), GameMart may not be able to transfer the factory lease as part of a 363 sale.

Commented [la72]: Incorrect, lease provisions would be ineffective to restrict assignment as this doesn't meet the elements of 365(c)(3)

Commented [la73]: Incorrect, this requirement of adequate assurance is the Bankruptcy Code's requirement for assumption and assignment

* End of Assessment *