



**28/50 = 56%**

**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** [1a1] (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**<sup>[1a2]</sup>

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**<sup>[1a3]</sup>

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**<sup>[1a4]</sup>

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**<sup>[1a5]</sup>

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**<sup>[1a6]</sup>

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**<sup>[1a7]</sup>

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**<sup>[1a8]</sup>

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**

<sup>[1a9]</sup>

**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**<sup>[1a10]</sup>

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**<sup>[1a11]</sup>

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** [1a12] (direct questions) [10 marks]

**Question 2.1** [1a13] (1 mark)

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

Ans:-

The word "Setoff" denotes a permission to a creditor holding a claim against the debtor and simultaneously owing money to the debtor to net out the two (or more) obligations. Because setoff rights can improve the position of the creditor as compared to other unsecured creditors who are not owed money by the debtor because it decreases its obligation to the estate by the full amount owed by the debtor rather than the lesser amount the debtor would pay on the unsecured claim, setoff is not permitted in a number of circumstances:

- the creditor's claim against the estate is disallowed;
- the creditor's claim against the estate was acquired post-petition or in the 90 days prior to the petition at a time when the debtor was insolvent;
- the creditor's obligation to the debtor was incurred in the 90 days prior to the petition at a time when the debtor was insolvent for the purposes of exercising setoff rights
- the creditor improves its position by setoff as compared to when its position had been exercised 90 days prior to the petition.

**Question 2.2** [1a16] [2 marks]

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

Ans:-

In my opinion, Bankruptcy Rules, the Federal Rules of Civil Procedure, the local rules of the bankruptcy court and the judge's personal practices should be reviewed when preparing a filing for a Bankruptcy Court.

**Question 2.3** [1a21] [2 marks]

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

Ans:-

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<sup>[1a23]</sup> with the consent of affected creditors<sup>[1a24]</sup>, but deviation is not permitted in chapter 7, where the statutory priorities must be strictly followed.

**Question 2.4<sup>[1a25]</sup> [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:-

Lender/ creditor is considered primed when it is surpassed by another lender with respect to its priority status regarding the collateral of a secured loan<sup>[1a26]</sup>. If financing cannot be obtained on any other terms<sup>[1a27]</sup>, 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. The debtor also must demonstrate that the interest of the secured creditor being primed is adequately protected<sup>[1a28]</sup>.

**Question 2.5<sup>[1a29]</sup> [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:-

A preference is a transfer of the debtor’s property made in a suspect period before the petition date that must be returned to the estate if it exceeds the amount the recipient would have received in a chapter 7 liquidation had the transfer not been made.<sup>[1a30]</sup>

The elements of a preference claim that need to be proved are:

- (1) A transfer of an interest of the debtor in property<sup>[1a31]</sup>
- (2) To or for the benefit of a creditor<sup>[1a32]</sup>
- (3) For or on account of an antecedent debt<sup>[1a33]</sup> owed by the debtor before such transfer was made
- (4) Made while the debtor was insolvent
- (5) Made during the suspect period
- (6) That enables the creditor to receive more than it would have in a chapter 7 liquidation

If all the elements of a preference claim are proved<sup>[1a34]</sup>, the claim is avoided and the money must be returned unless there is a valid defence.

### QUESTION 3 [1a35] (essay-type questions) [15 marks in total]

#### Question 3.1 [1a36] [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?

Ans:-

An order that is constitutionally final [1a37] 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. Conversely, 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. Final orders may be appealed as of right, whereas interlocutory orders may be appealed only with leave of the appellate court

#### Question 3.2 [1a38] [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?

Ans:-

A case under chapter 15 is commenced only by the filing of a petition by the foreign representative of the debtor—the debtor cannot be placed in chapter 15 involuntarily by a creditor filing. The filing of the petition, however, does not automatically invoke a stay of creditor action; the stay arises only upon the petition for recognition of a foreign main proceeding being granted [1a39] and is limited to the property of the debtor within the territorial jurisdiction of the United States. The Bankruptcy Court may grant a stay or other assistance on an interim basis pending recognition or following recognition of a non-main proceeding.

Following reliefs may be granted on a discretionary basis :-

- automatic stay
- operation of the debtor's business in the ordinary course by the foreign representative,
- sale, transfer or use of property outside the ordinary course,
- avoidance of post-petition transfers and post-petition perfection of security interests, [1a40]
- authorization of discovery regarding the debtor's assets and affairs [1a41],



- entrusting administration of the debtor's US assets to the foreign representative or other person<sup>[1a42]</sup>,
- extension of provisional relief<sup>[1a43]</sup>,
- any other relief "necessary to effectuate the purposes of [chapter 15] and to protect the assets of the debtor or the interests of creditors.

### Question 3.3 <sup>[1a44]</sup> [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?

Ans:-

Directors' duties:- The directors have acted in good faith for the corporation on the basis of best information available to them<sup>[1a45]</sup>.

Directors' duties are owed to the corporation and its shareholders, not to creditors, even in circumstances where the corporation is potentially insolvent<sup>[1a46]</sup> and therefore the shareholders stand to receive nothing in bankruptcy.

Under the business judgment rule<sup>[1a47]</sup>, the board of directors is presumed to have acted in good faith on the basis of reasonable information. This presumption can be rebutted only by showing that a majority of the board in fact were not reasonably informed, did not honestly believe that their decision was in the corporation's best interest, or were not acting in good faith. Unless the presumption is rebutted, the directors will not be liable in the absence of a showing of gross negligence

### Question 3.4 <sup>[1a48]</sup> [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.

Ans:-

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

i) The claim should not be "Non-contingent". <sup>[1a49]</sup>

A contingent claim is one that depends on the occurrence of a future event.<sup>[1a50]</sup>

ii) A debt that is unmatured (because the payment is due in the future) is not contingent if all requirements for liability, other than the passage of time, have occurred.

- Not the subject of *bona fide* dispute as to liability or amount<sup>[1a51]</sup>

- A bona fide dispute exists if there is an objectively reasonable basis for a dispute as a matter of fact or law; [1a52] the debtor's subjective belief that the debt is not owed or the amount claimed is incorrect is not sufficient.
- If a portion of the amount claimed is disputed, the creditor cannot use the undisputed portion to reach the monetary threshold required in the next bullet, but a dispute as to one claim does not disqualify application of other, undisputed claims held by the same creditor to meet petitioning creditor requirements.
- Unsecured or undersecured, [1a53] separately or in the aggregate with all other petitioning creditors' claims, in the amount of at least USD 16,750 [1a54] (this amount is periodically increased due to inflation)

**QUESTION 4 [1a55] (fact-based application-type question) [15 marks in total]**

**Question 4.1 [1a56] [5 marks]**

Speculation Inc is engaged in day-trading stocks from leased office space with two employees. It funds its trading through a margin loan from its broker, where the shares it purchases are held as collateral. For a while, Speculation Inc was very successful in trading, and the US Department of Justice (DOJ) has announced an investigation into whether its success was due to illegally trading on insider information. More recently, Speculation Inc has had serious trading losses, causing its broker to declare a default on the margin loan. It also has fallen behind on its rent, and been sued by a former employee alleging she was fired due to gender bias.

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 is a 'Debtor in possession' proceedings.

i) DOJ investigation: - There will be no much effect on ongoing investigation [1a57]. But, if any fraud, misconduct is being revealed as a result of any such investigation, things like imposing monetary penalty, fine etc won't be possible [1a58] due to Chapter 11 filing.

ii) margin loan default:- Broker wont be able to file for recovery proceedings [1a59] against Speculation Inc as Speculation Inc has already filed for Chapter 11 proceedings. The Broker firm needs to file its claim in this process and need to wait for its resolution/ outcome.

iii) delinquent lease:- Lease agreement cannot break/ stopped during Chapter 11 proceedings. Speculation Inc cannot be compelled to vacate the place even if there is default in payment of rent [1a60] as given in lease agreement. Speculation Inc will get this protection due to Chapter 11 filings.

iv) employment discrimination lawsuit:- Chapter 11 filings cannot stop investigation/hearing in this matter [1a61] and the company management has to face it. But in case any monetary penalty,

fine is imposed because of it, then Chapter 11 filings will come into play & the company may seek protection from any such penalty, fine.

**Question 4.2**<sup>[1a62]</sup> [5 marks]

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?

Ans:-

In 2005, as part of the Bankruptcy Abuse Prevention and Consumer Protection Act, the US adopted the UNCITRAL Model Law on Cross-Border Insolvency, as chapter 15 of the Bankruptcy Code.

Herein, the US does not exercise jurisdiction or authority over the entire estate (indeed, no estate is created under chapter 15) but rather provides assistance to the foreign proceedings concerning the debtor. There is no reciprocity of treatment required; US courts will recognize proceedings in countries that would not recognize US proceedings

English scheme of arrangement would be recognised by a US Bankruptcy Court and as COMI in the given case is Paris, France<sup>[1a63]</sup>, it will be recognised as foreign main proceedings<sup>[1a64]</sup>.

**Question 4.3**<sup>[1a65]</sup> [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?

Ans: No. As there looks to be no non-performance/ dishonor/ breach of contract on the part of ToyCo, one of the parties to the contract. It can be called an executory contract only when there is some default/ dishonorment from both sides. <sup>[1a66]</sup>

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

Ans:- As it's an exclusive contract between Toyco & GameMart, it cannot be sold as part of 363 sale without Toyco's consent.<sup>[1a67]</sup> If it happens so, Toyco may refuse to accept it. 363 Sale should be free from any other's interest, which is not the case here.

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

Ans: No<sup>[1a68]</sup>. As lease agreement specifically mentions that Land Corp's consent is a must, no such 363 sale can happen in the given case.

If Land Corp permits, then such transfer of factory lease would be possible.

**\* End of Assessment \***