



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).***
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- 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.*
- (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^[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 [1a13] (direct questions) [10 marks]

Question 2.1 [1a14] (1 mark)

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

[Setoff means the situation where a debtor (A) is allowed to net out its debts owed to a creditor (B) against the debts that the said creditor (B) owes to the said debtor (A) at the same time.] [1a15].

It is not permitted in many circumstances in the bankruptcy context because debtors of the insolvent company with set-off rights may be able to repay less to the insolvent estate of the bankrupt company, which would (i) decrease the overall value of the insolvent estate and (ii) improve the position of creditors with set-off rights vis-à-vis those general creditors without set-off rights. [1a16].]

Question 2.2 [1a17] [2 marks]

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

[One should review (i) the Federal Rules of Bankruptcy Procedure [1a18], (ii) the Federal Rules of Civil Procedures [1a19], (iii) the local rules of procedure of the bankruptcy court in question [1a20] and (iv) the personal practices issued by the judge in question [1a21].]

In respect of (iii) and (iv) above, in case of doubt, one should consult a local practitioner for advice on local practices that have not been put in writing.]

Question 2.3 [1a22] [2 marks]

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

[The absolute priority rule requires that in bankruptcy cases, full payment must be made to each category of claims before the subsequent category may receive any payment.] [1a23]

Derivation from the rule is permitted in a chapter 11 plan [1a24] (but not chapter 7 proceedings) provided that the affected creditors provide their consent [1a25].]

Question 2.4 [1a26] [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 granted by the Court to funders of DIP financing which provides the financing in question with higher or equal priority in the assets/collaterals of the company over the pre-petition secured creditors.]^[1a27]

Before such lien is to be granted, it must be shown that (i) DIP financing cannot be obtained on any other terms^[1a28]*and (ii) there would be adequate protection over the interest of the secured creditor that is being primed*^[1a29].]

Question 2.5^[1a30] [3 marks]

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

[Preference means transfer of property of the debtor during a "suspect period" before the date of bankruptcy petition to the insolvent estate if the value of such transfer is higher than the amount that the recipient (creditor) would have received in a chapter 7 scenario had the said transfer not been made in the first place.]^[1a31]

In gist, the elements of a preference claim include (i) transfer of debtor's interest in property^[1a32] *(ii) to or for the benefit of a creditor*^[1a33] *(iii) for or on account of an antecedent debt*^[1a34] *(owed by the debtor before the transfer in question was made) (iv) during the "suspect period" (v) while the debtor was insolvent (vi) which would enable to the creditor to receive more than it would have received in a chapter 7 liquidation.*

It is not necessary to show any fault of either the debtor or recipient (creditor) in connection with the payment involving preference.^[1a35].]

QUESTION 3^[1a36] (essay-type questions) [15 marks in total]

Question 3.1^[1a37] [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?

[Generally speaking, a bankrupt court, which derives its jurisdiction from the Bankruptcy Code, may only enter a final order in respect of matters in "core proceedings" (subject to exception below). While "core proceedings" are not statutory defined, a non-exhaustive list of "core proceedings" can be found under 28 U.S.C. §157.

An exception is that unless with the consent of the parties^[1a38]*, the bankruptcy court is unable to issue final orders that invade Article III jurisdiction even in core proceedings:*^[1a39] *see Stern v Marshall 564 US 462 (2011) and Fed R Bankr P 7008. If parties do not consent to issuance of final orders by the bankruptcy court, the*

bankruptcy judge may issue a report and recommendation for review by the district court^[la40].

Insofar as appeal is concerned, appeals against decisions of bankruptcy court are heard by the district court^[la41] for the district in which they sit (or, in limited cases, by a Bankruptcy Appellate Panel^[la42] comprising judges of the bankruptcy courts within the circuits).

In case of a non-final order, the district court (or the Bankruptcy Appellate Panel) would review all findings of fact and conclusions of law being appealed against on *de novo* basis.]

Question 3.2^[la43] [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 recognition of a foreign main proceeding, the following provisions of the Bankruptcy Code automatically apply to the debtor's property within the territorial jurisdiction of the US according to 11 U.S.C. §1520:-

- (i) Automatic stay:^[la44] see §1520(a)(1);
- (ii) Operation of the debtor's business in the ordinary course of business by the foreign representative:^[la45] see §1520(a)(3);
- (iii) Sale, transfer or use of the property outside the ordinary course of business:^[la46] see §1520(a)(2); and
- (iv) Avoidance of post-petition transfers and post-petition perfection of security interests: e §§1520(a)(2)&(4).

For completeness, upon recognition of a foreign non-main proceeding, the said reliefs may be granted on a discretionary basis.

Meanwhile, the following reliefs may be granted on a discretionary basis for either main or non-main proceeding:-

- (i) authorization of discovery in respect of assets and affairs of the debtor^[la47]: see §1521(a)(4);
- (ii) entrusting administration of the assets of the debtor in the US to the foreign representative or other designated entities^[la48]: see §1521(a)(5);
- (iii) extension of provisional relief^[la49]: see §1521(a)(6); and
- (iv) any other relief that are necessary to effectuate the purpose of chapter 15 proceedings and to protect the debtor's assets or the creditors' interest: see §1521(a)(7).]

Question 3.3 [1a50][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 the context of a Delaware corporation, a director owes the following duties to the company in the ordinary course of business:-

- (i) Fiduciary duty of loyalty* [1a51] *to the best interest of the company; and*
- (ii) Duty of care* [1a52] *in educated decision-making (subject to the business judgment rule (see below));*

Even when the company is potentially or actually insolvent, directors of a Delaware company only owe their duties to the company and its shareholders but not to the creditors of a company: [1a53] *see North Am Catholic Educational Programming Foundation, Inc v Gheewalla* **930 A.2d 92, 103 (Del 2007).**

Directors are protected from liability for errors of judgment under the business judgment rule [1a54]. *Under the rule, directors would be presumed to have acted in good faith based on reasonable information. The presumption can be rebutted (and thus directors would not be protected by the business judgment rule) if the majority of the board, as a matter of fact, were not reasonably informed or did not honestly believe that their decision was made in the best interest of the company or were not acting in good faith. Alternatively, the rule also does not apply to protect the directors in the case of (a) gross negligence on the part of the directors or (b) the 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 scenario (b) above, the transaction in question would be void unless the entire fairness standard can be met.*

For completeness, directors may not be liable for breach of duty of care if they are exculpated from liability by the certificate of incorporation of the Delaware company.]

Question 3.4 [1a55][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.

[In order to qualify as a petitioning creditor in an involuntary proceeding, the creditor must have a claim that meet the following requirements:-

- (i) **The claim must be non-contingent^[la56], i.e. it must be mature^[la57] and must not depend on the occurrence of a future event^[la58] e.g. default under a guaranteed obligation.**
- (ii) **There must not be any bona fide dispute as to liability or quantum of the claim^[la59]. Such dispute exists when there is an objectively reasonable basis for a dispute to be raised by the debtor as a matter of law or fact.^[la60] It should be noted that the debtor's subjective belief *per se* does not give rise to bona fide dispute.**
- (iii) **The claim must be unsecured or under-secured^[la61].**
- (iv) **The claim must, by itself or in the aggregate with all other petitioning debts, be in the sum of not less than USD 16,750^[la62] (which is subject to adjustment from time to time in view of inflation). If there is bona fide dispute in respect of part of the petitioning debt, the undisputed part alone must meet this quantum requirement.]**

QUESTION 4^[la63](fact-based application-type question) [15 marks in total]

Question 4.1^[la64][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?

[At the outset, it is noted that immediately upon the filing of the Chapter 11 petition, a worldwide automatic comes into effect^[la65] under 11 U.S.C. §362.

(i) DOJ Investigation

DOJ investigation should not be affected by the Chapter 11 petition^[la66].

While the scope of the stay is very broad, it does not cover any regulatory investigation: see 11 U.S.C. §362(b). As such, the DOJ investigation against Speculation should continue notwithstanding the filing of the Chapter 11 petition.

(ii) Margin loan default

Due to the Chapter 11 petition, Speculation's broker would be barred from commencing legal action against Speculation based on the loan.

While Speculation's broker does have a prima facie cause of action against Speculation for its default on the loan, such claim arose before the filing of Chapter 11 petition and the automatic stay triggered by the filing of Chapter 11 petition by Speculation would cover such claim (for being litigation on pre-petition claims). Specifically, such claim would fall within the scope of 11 U.S.C. §362(a)(1) which provides that the stay would apply to:-

"the commencement or continuation, including the issuance or employment of process, of a judicial, administrative, or other action or proceeding against the debtor that was or could have been commenced before the commencement of the case under this title, or to recover a claim against the debtor that arose before the commencement of the case under this title."

Thus, insofar as the margin loan default is concerned, Speculation's broker is bound by the automatic stay provision upon the filing of Chapter 11 petition [la67].

(iii) Delinquent lease

For reasons same as those set out in (ii) above, in view of the filing of the Chapter 11 petition, Speculation's landlord may not sue Speculation for breach of tenancy agreement.

Relatedly, Speculation's landlord also cannot take legal action against Speculation to "obtain possession of property of the estate or of property from the estate or to exercise control over property of the estate" under the tenancy agreement [la68] upon the filing of Chapter 11 petition since such act is expressly covered by the automatic stay under 11 U.S.C. §362(a)(3).

For completeness, if the lease later expires, notwithstanding the Chapter 11 petition, Speculation's landlord may still evict Speculation from its office property upon such expiry: see 11 U.S.C. §362(b)(10).

(iv) Employment discrimination lawsuit

In view of the filing of the Chapter 11 petition, Speculation's former employee would be barred from continuing with her legal action [la69] against Speculation since such claim should fall within the scope of 11 U.S.C. §362(a)(1) (see above).]

Question 4.2 [la70][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?

[Chapter 15 recognition]

Chapter 15 of the Bankruptcy Code applies to “foreign proceeding” as statutory defiled in 11 U.S.C. §101(23), which provides that:-

“The term “foreign proceeding” means a collective judicial or administrative proceeding in a foreign country, including an interim proceeding, 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.”

As can be seen above, “foreign proceeding” is widely defined and should cover Stella’s English scheme of arrangement in the present case.

As such, Stella’s English scheme of arrangement may in principle be recognizable by a US bankruptcy court under Chapter 15 (unless the US Court finds that recognition of such proceedings would be manifestly contrary to US public policy, which appears not to be the case here).

For completeness, it should be noted that in order to recognized under Chapter 15, in order to the element of pending “foreign proceeding” as explained above, Stella must also show that the foreign representative is empowered to act by the proceeding: see 11 U.S.C. §101(24).

Whether main proceeding or not?

Assuming that the proceeding can be recognized, the next issue is whether the English scheme is to be considered to be (a) a foreign main proceeding or (b) a foreign non-main proceeding for the purpose of Chapter 15 of the Bankruptcy Code, which depends on whether or not the UK is Stella’s centre of main interests (“COMI”). If the UK is Stella’s COMI, then the scheme of arrangement would be a foreign main proceeding for the purpose of Chapter 15 of the Bankruptcy Code.^[la71]

As a starting point, there is a rebuttable presumption that a debtor’s COMI is its place of incorporation. As such, Stella’s COMI would be presumed to be France in the present case.^[la72]

According to the facts given, the relationship between Stella and the UK is only supported by the factors below:-

- (i) Some of Stella's retail stores are located in the UK; and*
- (ii) Stella's funding comes from a bank loan and Eurobonds, both of which are governed by English law. It follows that should disputes arise from such loan, the UK would be a proper jurisdiction for resolution of such disputes.*

In contrast, the following factors seem to support that Stella's COMI is not in the UK:-

- (i) Stella was incorporated in France*
- (ii) Stella's headquarters is in Paris.*
- (iii) Stella's products are made in Italy.*
- (iv) In addition to retail stores in the UK, Stella also has retail stores in other parts of Europe, Asia, and North America.*

In view of the above, it is more likely than not that Stella's COMI is not in the UK and thus the English scheme of arrangement would be considered as a foreign non-main proceeding.

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?***

[Generally speaking, a contract is executory if there are material unperformed obligations on the part of both parties to the contract.

In the present case, GameMart has a 10-year exclusive license to manufacture Xblox for which GameMart is paying monthly royalties to ToyCo. Since there are material unperformed obligations on the part of both GameMart and ToyCo, the license is very likely to be an executory contract.

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

[No [la77], GameMart cannot transfer the Xbox license as part of 363 sale without ToyCo's consent.

The license in question includes patent licence for GameMart to use such patent for the purpose of manufacturing Xbox. Generally speaking, consent from licensors is needed before patents are assigned.

The license in question is also likely to include a trademark licence for GameMart to use Xbox trademarks owned by ToyCo for the purpose of manufacturing Xbox. It has been held in the case of *In re Trump Entertainment Resorts, Inc.* 526 BR 116 (Bankr D Del 2015) that federal trademark law generally prohibits assignment of trademark licenses absent consent from licensor. [la78]

In view of the prohibition under substantive non-bankruptcy law, GameMart cannot pass the "hypothetical test" and transfer the Xbox license as part of 363 sale without ToyCo's consent under 11 U.S.C. §365(c).]

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

[At the outset, the lease in question appears to be an executory contract since it still has seven years to go. As such, the option of assignment of the lease appears to be open to GameMart.

Notwithstanding the express clause prohibiting assignment of the lease without Land Corp's consent, such lease should be assignable without Land Corp's consent [la79] because the Bankruptcy Code generally abrogates contractual restrictions on assignment [la80] to enable debtors to realise their assets. As can be seen from 11 U.S.C. §§365 (c) and (e), "whether or not such contract or lease prohibits or restricts assignment of rights or delegation of duties" does not affect GameMart's ability to assign the contract.]

*** End of Assessment ***