



SUMMATIVE (FORMAL) ASSESSMENT: MODULE 3A

THE INSOLVENCY SYSTEM OF THE UNITED STATES

This is the summative (formal) assessment for Module 3A of this course and is compulsory for all candidates who selected this module as one of their compulsory modules from Module 3. Please read instruction 6.1 on the next page very carefully.

If you selected this module as one of your elective modules, please read instruction 6.2 on the next page very carefully.

The mark awarded for this assessment will determine your final mark for Module 3A. ***In order to pass this module, you need to obtain a mark of 50% or more for this assessment.***

INSTRUCTIONS FOR COMPLETION AND SUBMISSION OF ASSESSMENT

Please read the following instructions very carefully before submitting / uploading your assessment on the Foundation Certificate web pages.

1. **You must use this document for the answering of the assessment for this module. The answers to each question must be completed using this document with the answers populated under each question.**
2. **All assessments must be submitted electronically in MS Word format, using a standard A4 size page and a 11-point Arial font. This document has been set up with these parameters - please do not change the document settings in any way. DO NOT submit your assessment in PDF format as it will be returned to you unmarked.**
3. **No limit has been set for the length of your answers to the questions. However, please be guided by the mark allocation for each question. More often than not, one fact / statement will earn one mark (unless it is obvious from the question that this is not the case).**
4. **You must save this document using the following format: [studentID.assessment3A]. An example would be something along the following lines: 202223-336.assessment3A. Please also include the filename as a footer to each page of the assessment (this has been pre-populated for you, merely replace the words "student number" with the student number allocated to you). Do not include your name or any other identifying words in your file name. Assessments that do not comply with this instruction will be returned to candidates unmarked.**
5. **Before you will be allowed to upload / submit your assessment via the portal on the Foundation Certificate web pages, you will be required to confirm / certify that you are the person who completed the assessment and that the work submitted is your own, original work. Please see the part of the Course Handbook that deals with plagiarism and dishonesty in the submission of assessments. Please note that copying and pasting from the Guidance Text into your answer is prohibited and constitutes plagiarism. You must write the answers to the questions in your own words.**
- 6.1 **If you selected Module 3A as one of your compulsory modules (see the e-mail that was sent to you when your place on the course was confirmed), the final time and date for the submission of this assessment is 23:00 (11 pm) GMT on 1 March 2023. The assessment submission portal will close at 23:00 (11 pm) GMT on 1 March 2023. No submissions can be made after the portal has closed and no further uploading of documents will be allowed, no matter the circumstances.**
- 6.2 **If you selected Module 3A as one of your elective modules (see the e-mail that was sent to you when your place on the course was confirmed), you have a choice as to when you may submit this assessment. You may either submit the assessment by 23:00 (11 pm) GMT on 1 March 2023 or by 23:00 (11 pm) BST (GMT +1) on 31 July 2023. If you elect to submit by 1 March 2023, you may not**

submit the assessment again by 31 July 2023 (for example, in order to achieve a higher mark).

7. Prior to being populated with your answers, this assessment consists of 9 pages.

ANSWER ALL THE QUESTIONS

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

Questions 1.1. - 1.10. are multiple-choice questions designed to assess your ability to think critically about the subject. Please read each question carefully before reading the answer options. Be aware that some questions may seem to have more than one right answer, but you are to look for the one that makes the most sense and is the most correct. When you have a clear idea of the question, find your answer and **mark your selection on the answer sheet by highlighting the relevant paragraph in yellow**. Select only ONE answer. Candidates who select more than one answer will receive no mark for that specific question.

Question 1.1

Which of the following entities does not satisfy the minimum presence requirement to be a debtor under any chapter of the Bankruptcy Code?

- (a) A foreign domiciled company that pays a US attorney a retainer.
- (b) A company with several US bank accounts, but no physical presence in the United States.
- (c) A company with US patents, but no physical presence in the United States.
- (d) **All of the above satisfy the minimum requirement for presence in the United States.**
- (e) None of the above satisfy the minimum requirement for presence in the United States.

Question 1.2

ABC Corp is an industrial manufacturing company that is filing for bankruptcy. Which of the following could not be considered a party in interest?

- (a) A neighboring landowner to ABC Corp's manufacturing plant.
- (b) **An environmental advocacy group that opposes ABC Corp's operations.**
- (c) The landlord of ABC Corp's corporate office.

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

Total marks 40/50. Note that the responses in section 2 and 3 are largely copied from the course text rather than the student's own writing.

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- (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

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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

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

Which of the following conditions must be true about a reorganization plan for a court to confirm it under Chapter 11 proceedings?

- (a) *Have a possibility of success, even if it relies on speculative or improbable events to be capable of execution.*
- (b) *The plan is not likely to be followed by liquidation.*
- (c) *All impaired classes must accept the plan.*
- (d) *All of the above.*
- (e) None of the above.**

Question 1.5

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Which of the following about cramdowns, is false?

- (a) *The plan of reorganization must be fair and equitable to all impaired classes.*
- (b) *Differential treatment of different classes is permitted if there is a reasonable, good faith basis for doing so and such treatment is required for the plan of reorganization to be successful.*
- (c) *Class definition is often a battleground when a debtor tries to cramdown classes.*
- (d) *Dissenting creditors are permitted to challenge the classification of a creditor supporting the cramdown.*
- (e) *If one insider creditor approves of the plan of reorganization, all other impaired classes may be crammed down.*

Question 1.6

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Which of the following about 363 sales is false?

- (a) *A good faith purchaser at a 363 sale may retain the property notwithstanding a subsequent reversal of court approval for the sale on appeal.*
- (b) *The debtor in possession must establish that the transaction is in the best interests of the estate as a whole.*
- (c) *In chapter 15 proceedings, a foreign court's approval alone suffices for a 363 sale.*
- (d) *Debtors must carry out a robust marketing process for the sale.*
- (e) *A creditor's lien on assets sold in a 363 sale attaches to the proceeds of the sale.*

Question 1.7

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Which of the following is true of both an actual fraudulent conveyance and a constructive fraudulent conveyance?

- (a) *The debtor must have had an actual intent to hinder, delay, or defraud any entity to which the debtor was or became indebted.*
- (b) *Both require at least circumstantial evidence of the fraudulent intent.*
- (c) *The debtor must have been insolvent at the time of transaction.*
- (d) *In addition to provisions in the Bankruptcy Code, the debtor or the trustee may invoke applicable state or foreign fraudulent conveyance laws.*
- (e) *All of the above are true.*

Question 1.8

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.

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Question 1.9

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.

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Question 1.10

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.**

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QUESTION 2 (direct questions) [10 marks]

Question 2.1 (1 mark)

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

Under the Bankruptcy Code, setoff allows a creditor holding a claim against the debtor who simultaneously owes money to the debtor to net out the two (or more) obligations. As setoff rights can improve the position of the creditor compared to other unsecured creditors who are not owed money by the debtor by way of decreasing 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 allowed in a number of circumstances.

Question 2.2 [2 marks]

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

When preparing a filing for a bankruptcy court, you should review the Bankruptcy Rules, the Federal Rules of Civil Procedure, the local rules of the bankruptcy court and the judge's personal practices. It is advisable to consult with a local practitioner for advice on unwritten local practices if you do not practice regularly in the jurisdiction in which you are filing.

Question 2.3 [2 marks]

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

Under the absolute priority rule, it is a requirement that payment in full must be made to each category of claims before the next category receives anything. Deviation from the absolute priority rule is permitted with the consent of affected creditors in a chapter 11 plan, however deviation is not permitted in a chapter 7 plan, where the statutory priorities must be strictly adhered to.

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?

A priming lien is a new lien that is granted priority over existing liens on a debtor's assets. For a priming lien to be granted to secure debtor-in-possession financing, the debtor must demonstrate that the interest of the secured creditor being primed is adequately protected.

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Updated: 4.5 marks
Course Leader

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Commented [la28]: Correct, 1/2 mark, the debtor also must demonstrate that financing is not available without the priming lien

Question 2.5 [3 marks]

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

A preference is a transfer of the debtor's property made in a suspect period before the petition date that needs to be returned to the estate if it in excess of the amount the recipient would have received in a chapter 7 liquidation had the transfer not have occurred. There is no requirement for a showing of fault by either the debtor or the creditor in connection with the payment having been made, and the recipient creditor does not suffer any penalties except for the return of the transfer and potentially some prejudgement interest from the date of the transfer.

The elements of a preference claim that need to be proved are: (i) a transfer of an interest of the debtor in property (this could be funds, property or an interest in property, i.e. a lien); (ii) the transfer was to or for the benefit of the creditor; and (iii) the transfer was for or an account of an antecedent debt owed by the debtor to the creditor prior to the transfer being made; (iv) the transfer was made while the debtor was insolvent; (v) the transfer was made during the suspect period; and (vi) the transfer resulted in the creditor receiving more than it would have in a chapter 7 liquidation.

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

Question 3.1 [3 marks]

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

Bankruptcy courts in the US were created through legislation, rather than directly by Article III of the US Constitution, bankruptcy judges are appointed by courts of appeal, rather than the president, they do not have lifetime tenure and they also have limited jurisdiction to enter final orders other than on core bankruptcy issues. Bankruptcy judges may only hear and determine core proceedings. With respect to non-core proceedings, the bankruptcy court may hear the proceedings provided they are sufficiently related to a bankruptcy proceedings however they cannot make a final determination, and instead can only submit proposed findings of fact and conclusions of law to the district court. At the outset of each motion or pleading, parties need to state whether the matter at hand is core or non-core in order for the bankruptcy court to determine the scope of its jurisdiction and power to render a final order.

Final orders are orders that dispose of all issues, leaving nothing further to be decided. Interlocutory orders are orders that resolve only some issues or claims. Final orders can be appealed as of right, whereas interlocutory orders can only be appealed with leave of the appellate court. The US Supreme Court has held that a bankruptcy order resolving a discrete dispute is a final order for the purposes of an appeal. An order that is not constitutionally final as the bankruptcy court had authority to enter it is not final for the purposes of appeal if it does not resolve the whole issue in dispute. On the

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Course Leader

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Commented [la37]: Specifically, the bankruptcy court can enter a constitutionally final order on a core matter unique to the bankruptcy code, such as a challenge to a petition, or on any other core proceeding with the consent of the parties

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other hand, an order that resolves a dispute in its entirety and would therefore be final for the purposes of appeal may not be final in the constitutional sense if the parties have not consented to the jurisdiction of the bankruptcy court.

Appeals from bankruptcy court decisions are heard by the district court for the district in which they sit. However, in certain circumstances bankruptcy appeals are heard by a Bankruptcy Appellate Panel ("BAP") which is convened from the judges of the bankruptcy courts within the circuit.

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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?

Following the recognition of a foreign main proceeding, certain provisions of the Bankruptcy Code automatically apply to the debtor's property within the territorial jurisdiction of the United States. These provisions are: (i) automatic stay; (ii) operation of the debtor's business in the ordinary court by the foreign representative; (iii) sale, transfer or use of the property outside the ordinary court of business; and (iv) avoidance of post-petition transfers and post-petition perfection of security interests.

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Upon the recognition of a foreign non-main proceeding, relief may be granted on any of the above points on a discretionary basis. Additionally, following recognition as either a foreign main or foreign non-main proceeding, relief may also be granted on a discretionary basis on the following: (i) authorisation of discovery regarding the debtor's affairs and assets; (ii) entrusting administration of the debtor's US assets to the foreign representative or other person; (iii) extension of provisional relief; and (iv) any other relief 'necessary to effectuate the purposes of [chapter 15] and to protect the assets of the debtor or the interests of creditors'.

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Question 3.3 [4 marks]

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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 ordinary course of business, directors owe a fiduciary duty of loyalty to the Delaware corporation's best interest as well as a duty of care in educated decision-making, however the directors are protected from liability for errors in judgement by way of the business judgement rule. Under this rule, the board of directors is presumed to have acted in good faith on the basis of reasonable information available to them. This presumption can be rebutted only by demonstrating that a majority of the board were in fact not reasonably informed, did not honestly believe that their decision was in the best interest of the corporation, or were not acting in good faith. Unless this

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presumption is rebutted, the directors are not liable in the absence of showing gross negligence on their part. Directors may also be exculpated by the certificate of incorporation of the corporation from liability for breach of the duty of care (but not for the breach of the duty of loyalty). The business judgment rule is not applicable where a transaction is approved by a majority of the board that is not disinterested and independent or if there is a controlling shareholder on both sides of the transaction. In these circumstances, the transaction will be void unless the entire fairness standard is satisfied.

When the Delaware corporation is potentially or actually insolvent, directors' duties are still owed to the corporation and its shareholders, not to creditors and therefore the shareholders stand to receive nothing in bankruptcy. The Delaware Supreme Court in *North Am Catholic Educational Programming Foundation, Inc v Gheewalla* solidified this fact by ruling that no directors owe duties to creditors when a company is operating 'in the zone of insolvency' or is indeed insolvent.

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Question 3.4 [5 marks]

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

In involuntary proceedings, in order to qualify as a petitioning creditor the creditor's claim must be:

(i) **Non-contingent**

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- A contingent claim depends on the occurrence of a future event, e.g. a claim under a guarantee (contingent until the occurrence of a default under the guaranteed obligation)
- A debt that is unmatured, i.e. because the payment is due in the future, is not contingent if all requirements for liability, except for the passage of time, have occurred.

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(ii) **Not the subject of bona fide dispute as to liability or amount;**

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- A bona fide dispute exists if there is an objectively reasonable basis for a dispute as a matter of law or fact; the debtor's subjective belief that the debt is not owed or the amount that is being claimed is not sufficient or incorrect.
- In the case where a portion of the amount claimed is in dispute, the creditor cannot use the undisputed portion to reach the monetary threshold of US\$ 16,750, however a dispute as to one claim does not disqualify application of other undisputed claims held by the same creditor in order to meet petitioning creditor requirements.

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(iii) **Unsecured or undersecured, separately or in the aggregate with all other petitioning creditors' claims, to the amount of a minimum of US\$ 16,750 (with this amount being periodically increased due to inflation)**

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Commented [la59]: Correct, 1/2 mark, also the petitioning creditor must allege that the debtor is not paying its debts as they become due

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

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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 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. **The effect of a Chapter 11 petition being filed by Speculation with regard to the DOJ investigation would result in an automatic stay of any proceeding against Speculation or its property which would provide some breathing space for Speculation to continue operating in the ordinary course of business. The stay would halt most legal actions and proceedings against Speculation, including the ongoing DOJ investigations. The ability of the DOJ to continue its investigation, issue subpoenas or take any other actions against Speculation may be temporarily paused until the bankruptcy court grants relief from the automatic stay. The DOJ as a government agency may also become actively involved in the Chapter 11 proceedings. Depending on the nature of the DOJ's investigation, they may assert claims, file objections or seek to protect the government's interests in the bankruptcy case.**

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Commented [la63]: Incorrect, the DOJ's investigation is exempt from the stay under the regulatory proceedings exception

However, if the DOJ has found evidence of criminal activity in their initial investigation the stay is not valid and the DOJ could continue their investigation despite Speculation's filing for Chapter 11.

- II. **The effect of a Chapter 11 petition being filed by Speculation with regard to the margin loan default would result in an automatic stay of any proceeding against Speculation or its property which would provide some breathing space for Speculation to continue operating in the ordinary course of business. Under Chapter 11, the automatic stay would protect Speculation's shares held as collateral for the margin loan from being enforced on by the broker. However, the broker, as a creditor, may seek relief from the automatic stay to enforce its**

Commented [la64]: Incorrect, the margin loan is a securities contract that is exempt from the stay, so the broker is free to sell the shares and apply the proceeds to the loan balance

rights against the collateral that secures the margin loan. They may do so by proving 'cause' to the bankruptcy court, i.e. a valid reason why it should be allowed to proceed with collection of the margin despite the automatic stay. One such reason may be that they have a fixed or floating charge over the collateral.

- III. The effect of a Chapter 11 petition being filed by Speculation with regard to the delinquent lease would result in an automatic stay of any proceeding against Speculation or its property which would provide some breathing space for Speculation to continue operating in the ordinary course of business. Speculation would be protected from eviction from their offices as a result of the automatic stay, giving them some time to reorganise their finances and potentially negotiate with their landlord to develop a plan for repayment of lease obligations.
- IV. The effect of a Chapter 11 petition being filed by Speculation with regard to the employment discrimination lawsuit would result in an automatic stay of any proceeding against Speculation or its property which would provide some breathing space for Speculation to continue operating in the ordinary course of business. The automatic stay granted to Speculation following their filing for Chapter 11 does not prevent the continuation of the employment discrimination lawsuit indefinitely however during the stay the plaintiff may be required to comply with a litigation hold. The employment discrimination lawsuit will then become part of the bankruptcy estate. The bankruptcy court will have jurisdiction over all claims against Speculation, including those arising from employment matters.

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Commented [la66]: Correct, the employment litigation would be stayed

Question 4.2 [5 marks]

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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 US Bankruptcy Code outlines the procedures for recognition of foreign proceedings and the coordination of US and foreign proceedings. The first factor to consider in this restructuring is where the centre of main interest ("COMI") of Stella SA is. Stella SA is incorporated in France and has its headquarters in Paris however it has retail stores in the UK and its funding comes from a bank loan and Eurobonds, both of which are governed by English law. Generally, a debtor's COMI is considered to be its place of incorporation, i.e. Paris however this is rebuttable. Due

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to the ties to England as mentioned above, the location of the majority of Stella's creditors that will be affected by the restructuring is England so I believe England could be considered to be Stella's COMI in this case and therefore commencing a scheme of arrangement in England would be considered as foreign main proceedings in the US, provided that Stella's COMI could be proven to be England.

Commented [la69]: Incorrect, where the headquarters are in the jurisdiction of incorporation, the presumption that the COMI is France is unlikely to be rebutted. Therefore, foreign main recognition would not be available.

If it can not be proven that England is Stella's COMI, then the scheme of arrangement would be recognised as a foreign non-main proceeding under Chapter 15.

Commented [la70]: Correct, 1 mark, the retail store in England would satisfy the establishment requirement.

Question 4.3 [5 marks]

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

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

The license to manufacture Xblox would be considered an executory contract as there are material unperformed obligations on both sides, i.e. GameMart has a 10-year obligation to manufacture Xblox and pay ToyCo the monthly royalties and ToyCo is required to continue granting the license to produce Xblox for the remainder of the 10-year license period.

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

Section 363 of the Bankruptcy Code provides for the sale of assets outside the ordinary course of business free and clear of all licences and other interest. Sales pursuant to section 363 can often achieve improved recoveries on assets of the estate and greater protection for purchases. In order to execute the 363 sale, GameMart would have to obtain approval from the bankruptcy court and the court will consider certain factors, such as whether the sale is in the best interest of the estate and its creditors. As ToyCo holds the patents for Xblox, their consent would be required as part of 363 sale.

Commented [la73]: Correct, 1 mark, this is because of the requirements of substantive intellectual property law

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

GameMart can transfer the factory lease as part of the 363 sale without Land Corp's consent as the lease of factory space is assignable without consent, notwithstanding the landlord approval provision which Land Corp has included in the lease.

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Commented [la75]: Correct, 1 mark

*** End of Assessment ***