



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^[a1]

QUESTION 1^[a2] (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^[a3]

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^[a4]

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 [a13] (direct questions) [10 marks]

Question 2.1 [a14] (1 mark)

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

Setoff permits a creditor that has a claim against a debtor - while at the same time owing money to that debtor - to net out the (two or more) obligations. [a15] What this means is that setoff rights can improve a creditor's position as against other unsecured creditors - because it decreases that creditor's obligation to the estate by the full amount owed by the debtor rather than the lesser amount the debtor would pay on the secured claim. Given this, setoff is not permitted in a number of circumstances. [a16]

Question 2.2 [a17] [2 marks]

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

When preparing a filing for a US bankruptcy court it is necessary to have regard to the Federal Rules of Bankruptcy Procedure [a18], the Federal Rules of Civil Procedure [a19], the local rules of the bankruptcy court [a20] and the judge's personal practices [a21].

Question 2.3 [a22] [2 marks]

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

The absolute priority rule prohibits any creditor or class of creditors from receiving less under a reorganisation plan than that creditor or class would receive under a hypothetical chapter 7 liquidation - pursuant to which claims would be paid in accordance with statutorily required priorities without consent of the affected creditor. That is, the rule requires that payment in full be made to each category of claims before the next category receives anything. [a23]

However, in a Chapter 11 plan, deviation from the rule may be permitted [a24] with the consent of affected creditors [a25] - but not under a Chapter 7 plan.

Question 2.4 [a26] [2 marks]

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

In circumstances where financing cannot be obtained on any other terms [a27], a court may grant a priming lien which is senior or equal to a pre-petition lien granted in relation to estate property [a28] in order to secure post-petition financing. The debtor must demonstrate that the interest of the secured creditor being "primed" is

adequately protected^[1a29]. If granted, the financing will take priority in collateral over the pre-petition secured lenders.

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?

A preference is a transfer of the debtor's property made in a suspicion period ahead of the petition date - that a court will order be returned to the estate if it exceeds the amount the recipient would have received in a Chapter 7 liquidation - if the transfer had not been made^[1a31](11 USC, 547).

The elements of a preference claim are:

- 1. A transfer of an interest of the debtor in property^[1a32];*
- 2. To or for the benefit of a creditor^[1a33];*
- 3. For on account of an antecedent debt^[1a34] 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.*

There is no requirement to show any fault on the part of the debtor or the recipient in connection with the payment^[1a35] - and the recipient creditor suffers no penalty other than return of the transfer (and prejudgment interest from the date of the transfer in some circumstances).

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?

A bankruptcy court may enter a final order only on core bankruptcy issues.^[1a38] At the outset of the matter, parties must state whether the issue before the court is "core" or "non-core" so the court can determine the scope of its jurisdiction and power to render a final order or judgment.

Generally speaking, appeals from the bankruptcy court are heard by the district court^[1a39] for the district court in which they sit. In certain circuits, however, appeals of bankruptcy decisions are heard by a Bankruptcy Appellate Panel^[1a40] convened from judges of the bankruptcy courts within the circuit.

If the ruling was in a noncore proceeding or the bankruptcy court otherwise did not have authority to enter a final order, the district court or Bankruptcy Appellate Panel reviews de novo all findings of fact and conclusions of law to which a party has objected^[la41].

Question 3.2 ^[la42][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:

1. *Automatic stay* ^[la43]
2. *Operation of the debtor's business in the ordinary course by the foreign representative*^[la44];
3. *Sale, transfer or use of property outside the ordinary course*^[la45];
4. *Avoidance of post-petition transfers and post-petition perfection of security interest.*

Upon recognition, any of the above kinds of relief may be granted on a discretionary basis. Further, upon recognition (be it as foreign main or foreign non-main) the following relief may also be granted on a discretionary basis:

1. *Authorisation of discovery regarding the debtor's assets and affairs*^[la46];
2. *Entrusting administration of the debtor's US assets to the foreign representative or other person*^[la47];
3. *Extension of provision relief*^[la48];
4. *Any other relief "necessary to effectuate the purposes of chapter 15 and to protect the assets of the debtor or the interest of creditors" (11 USC, 1521(a)).*

Question 3.3 ^[la49][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?

*Directors of a Delaware corporation in the ordinary course of business owe a fiduciary duty of **loyalty** ^[la50] to act in the corporation's best interest and a duty of **care** ^[la51] in educated decision making.*

Directors' duties are owed to the company and its shareholders (not to creditors) when a corporation is potentially insolvent and/or actually insolvent.^[la52]

Directors are protected from liability from errors of judgment by the business judgment rule.^[la53] **Under this rule, the board is presumed to have acted in good faith on the basis of reasonable information. The presumption, however, can be rebutted - but only by showing that a majority of the board were, in fact, not reasonably informed, did not honestly believe their decision was in the corporation's best interest, or were not acting in good faith.**

Question 3.4^[la54] [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 must have a claim against the debtor that is:

1. **Non-contingent**^[la55]
 - a. **A contingent claim is a claim that depends on the occurrence of some future event**^[la56]
 - b. **A debt that is unmatured (as the payment is due in the future) is not contingent if all requirements for liability (other than passage of time) have occurred.**
2. **Not the subject of bona fide dispute as to the liability or the amount**^[la57]
 - a. **A bona fide dispute exists where there is an objectively reasonable basis for the dispute as a matter of law or fact**^[la58] **(subjective belief is not sufficient);**
 - b. **If part of the amount is disputed, the creditor cannot use the undisputed portion to reach the monetary threshold (see below) - but a dispute as to one claim does not of itself disqualify application of other undisputed claims of the creditor;**
3. **Unsecured or under-secured**^[la59] **separately or in the aggregate with all other petitioning creditors' claims in the amount of minimum** **USD 16,750**^[la60].

Further, the involuntary petition form requires the petitioning creditors to allege either that the debtor is generally not paying its debts as they become due - unless they're the subject of a bona fide dispute as to liability or amount - or that within 120 days before filing the petition, that a custodian other than a trustee, receiver or agent appointed to take charge of less than substantially all of the property of the debtor for the purposes of enforcing a lien against the property was appointed or took possession^[la61].

QUESTION 4^[la62] (fact-based application-type question) [15 marks in total]

Question 4.1 [1a63] [5 marks]

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

What would be the effect of a Chapter 11 petition being filed by Speculation Inc on each of the (i) DOJ investigation, (ii) margin loan default; (iii) delinquent lease and (iv) employment discrimination lawsuit?

- DOJ investigation. ***The filing of a Chapter 11 petition would not have any effect on the DOJ investigation. The automatic stay is subject to certain statutory exceptions, including regulatory investigations*** [1a64].
- Margin loan default. ***Pursuant to the safe harbours for securities and commodities contracts, margin payments are one type of payment that cannot be avoided as preferences or fraudulent conveyances - unless the transfer was made with the intent to defraud creditors.*** [1a65]
- Delinquent lease. ***The effect of the Chapter 11 petition on the lease will depend on whether the term of the lease has expired. If expired, the landlord may bring proceedings against Speculation to remove them from the premises regardless of the automatic stay pursuant to the statutory exemption. If the lease remains on foot, Speculation must elect to reject, assume or assign the executory contract within 120 days.*** [1a66]
- Employment discrimination suit. ***Upon the filing of a Chapter 11 petition, the automatic stay prevents the filing of any legal proceedings against the debtor*** [1a67]. ***Given there is no exemption for discrimination claims, the employee would be prevented from filing the suit.*** [1a68]

Question 4.2 [1a69] [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?

The fact of the retail stores in North America would satisfy the minimum presence requirement and allow Stella to be considered a debtor for the purposes of Chapter 15.

In order for the English scheme to be recognised in the US pursuant to Chapter 15, the foreign representative must establish that a foreign court or administrative proceeding with respect to the debtor is pending and that the foreign representative is empowered to act by the proceeding (11 USC, 101(23)).

The more complex issue will be whether the foreign proceeding will be characterised as a foreign main or foreign non-main proceeding. A foreign main proceeding is one commenced in the debtor's centre of main interests (COMI). [1a70] The question, therefore, is (in order to be considered the main proceeding) is whether England is Stella's COMI.

Stella's COMI will be presumed to be its place of incorporation (i.e. France), [1a71] but this presumption may be rebutted by reference to other facts including:

- The location of its headquarters - also Paris, France*
- Location of management - presumably Paris, France*
- Location of primary assets - presumably Italy (i.e. manufacturing) and wherever its final product is stored/highest in volume*
- Location of a majority of the debtor's creditors or a majority of the creditors that will be affected by the relief requested by the foreign representative - given that Stella's funding comes from a bank loan and Eurobonds, both of which are governed by English law, this weighs in favour of England being the COMI*
- Jurisdiction whose law will apply to most disputes - this again is England given the bank loan and Eurobonds are governed by English law*

There is a question here as to where the creditors are based, which would be an important consideration. Given that it this remains unclear, it would seem that there is a chance Stella's COMI would be deemed Paris [1a72] - but given the legal issues likely to arise and to be disputed in England - it is also arguable that the more appropriate jurisdiction for the purposes of COMI is England.

Question 4.3 [1a73] [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 Xbox an executory contract?

No. Gamemart currently pays monthly royalties to ToyCo, and ToyCo provides an exclusive license to manufacture Xbox. Thus, there is no under performance [la74] of the contract by either party which would trigger the contract becoming executory.

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

No[la75]. Licensees of patents and copyrights owned by a debtor are protected such that their licenses may not be terminated in connection with the sale of the intellectual property without their consent (section 365(n) of the Bankruptcy Code).[la76]

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

No[la77]. A contract is only deemed an executory contract when there is under performance on both sides. From the facts, it seems that the Landlord has not failed to perform its side of the agreement. Thus, it is not assignable without consent.

* End of Assessment *