



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**<sup>[la1]</sup>

**QUESTION 1**<sup>[la2]</sup> (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>[la3]</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>[la4]</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>[1a5]</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>[1a6]</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>[1a7]</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>[1a8]</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>[1a9]</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>[1a10]</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>[1a11]</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>[1a12]</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** [1a13] (direct questions) [10 marks]

**Question 2.1** [1a14] (1 mark)

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

*A setoff is where a creditor holding a claim against a debtor, simultaneously owes money to the debtor and the obligations are netted out as against each other. It is not permitted in many circumstances as can improve the position of the creditor as against other creditors.*

**Question 2.2** [1a17] [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;
- Federal Rules of Civil Procedure;
- local rules of the bankruptcy court (and the judge's personal practices).

**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 certain employee expenses, primarily for unpaid salaries and contributions to employee benefit plans for the 180 days prior to the petition date or cessation of business can receive no worse treatment under a plan of reorganisation than they would have received in a chapter 7 liquidation. The rule can be deviated from with consent of the employee.

**Question 2.4** [1a25] [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 senior or equal to a pre-petition lien on estate property. A priming lien may be granted by the Court in circumstances where financing cannot be obtained on any other terms. Further, a debtor must demonstrate that the interest of the secured creditor is adequately protected.

**Question 2.5** [1a29] [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 where a debtor transfers property in a suspect period before the petition date. The property must be returned to the estate if the amount received by the creditor exceeds that which they would have obtained in a chapter 7 liquidation had the transfer not been made.<sup>[1a30]</sup>

The requirements to prove a preference are:

- a transfer of an interest of the debtor property<sup>[1a31]</sup>;
- to or for the benefit of a creditor<sup>[1a32]</sup>;
- for or on account of an antecedent debt<sup>[1a33]</sup> owed by the debtor before the transfer was made;
- made while the debtor was insolvent;
- made during the suspect period;
- that enables the creditor to receive more that it would have in a chapter 7 liquidation.

It is not necessary to show fault by either the debtor or recipient to establish a preference.<sup>[1a34]</sup>

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

#### Question 3.1<sup>[1a36]</sup> [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 in relation to "core" bankruptcy issues and limited jurisdiction to make final orders in other matters. The Bankruptcy Code sets out a non-exhaustive list of core proceedings upon which a bankruptcy court may make final orders. However, the Court may not issue a final order in so far as that matter over state law claims as this was determined by the Supreme Court to be unconstitutional under Article II<sup>[1a37]</sup>, unless the parties provide consent<sup>[1a38]</sup>. Similarly, a bankruptcy court may issue final orders in relation to "non-core" matters if the parties provide consent in advance.

Generally, the district court hears appeals<sup>[1a39]</sup> from bankruptcy courts within its district. However, in certain circuits, appeals are heard by a Bankruptcy Appellate Panel<sup>[1a40]</sup> unless a party requests that the appeal is heard by the district court instead.

If the court makes a ruling that is not a final order, the district court or Bankruptcy Appellate Panel reviews all findings of fact and conclusions of law that are appealed on a *de novo* basis<sup>[1a41]</sup>.

#### Question 3.2<sup>[1a42]</sup> [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 will automatically apply to the debtor's property that is within the United States' jurisdiction:

- Automatic stay<sup>[1a43]</sup>;



- operation of the debtor's business in the ordinary course by the foreign representative<sup>[1a44]</sup>;
- sale, transfer or use of property outside the ordinary course<sup>[1a45]</sup>; and
- avoidance of post petition transfers and post petition perfection of security interests.

All of the above provisions may be granted on a discretionary basis in the case of recognition of foreign non-main proceedings. In both foreign main and non-main proceedings, the following discretionary relief may also be granted:

- Authorisation of discovery regarding the debtor's assets and affairs<sup>[1a46]</sup>;
- entrusting administration of the debtor's assets to the foreign representative or other person<sup>[1a47]</sup>;
- extension of provisional relief<sup>[1a48]</sup>; and
- any other relief necessary to effectuate the purposes of chapter 15 and to protect the assets of the debtor or interest of creditors.

### Question 3.3<sup>[1a49]</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?**

Directors owe a fiduciary duty of loyalty<sup>[1a50]</sup> to act in the corporation's best interest and a duty of care<sup>[1a51]</sup> in educated decision making.

Director's duties are owed to the company and its shareholders when the corporation is potentially or actually insolvent.<sup>[1a52]</sup> Directors are protected from liability from errors of judgment by the business judgment rule in the absence of gross negligence.<sup>[1a53]</sup>

Directors are presumed to have acted in good faith on the basis of reasonable information under the business judgment rule. However, the rule may be rebutted by showing that a majority of the board were 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<sup>[1a54]</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.**

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

- non-contingent<sup>[1a55]</sup> - meaning the claim does not depend on the occurrence of a future event but rather has already crystallised<sup>[1a56]</sup> (noting that an unmatured debt is not contingent if all requirements for liability, but for the passage of time, have occurred);
- not the subject of a bona fide dispute as to liability or amount<sup>[1a57]</sup> - meaning there may not be an objectively reasonable basis for a dispute in relation to a matter of fact or law.<sup>[1a58]</sup>
- in the amount of at least USD \$16,750<sup>[1a59]</sup> and is unsecured or under secured<sup>[1a60]</sup>, separately or in the aggregate with all other petitioning creditors' claims.

It is also necessary for the creditor to allege that the debtor is generally not paying its debts as they become due (unless subject to a bona fide dispute as to liability or quantum). Alternatively, the creditor must allege 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.<sup>[1a61]</sup>

**QUESTION 4**<sup>[1a62]</sup>(fact-based application-type question) [15 marks in total]

**Question 4.1**<sup>[1a63]</sup> [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 have no impact on the DOJ investigation. While a stay of proceedings would automatically follow from filing the petition<sup>[1a64]</sup>, regulatory investigations are exempt from the stay by way of statute.<sup>[1a65]</sup>

Margin loan default

Filing of the chapter 11 petition would not prevent the broker from calling upon the shares as collateral following default.<sup>[1a66]</sup> Unless the transfer is made with the intent to defraud creditors, the recovery of the shares by the broker will not be avoided despite being done after filing the petition due to the safe harbour provided to securities and commodities contracts.

Delinquent lease

The effect of the petition will depend on whether the term of the lease has expired or not. If the lease has expired, the landlord may commence proceedings to evict<sup>[1a67]</sup> Speculation regardless of the automatic stay due to a statutory exemption. If the lease has not expired, Speculation will be required to make a decision in relation to the executory contract within 120 days of the order for relief.

Employment discrimination lawsuit

An automatic stay prevents litigation on pre-petition claims upon filing of a chapter 11 petition. There is no statutory exemption for discrimination claims. Accordingly, the employee would be stayed from bringing her claim<sup>[1a68]</sup>.

**Question 4.2** [1a69][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?***

Recognition

The presence of a retail store, being a place of business, will satisfy the minimum requirement to be a debtor under the Bankruptcy Code. Equally, the presence of assets in the form of stock held in the retail store would also satisfy the presence of assets requirement. Accordingly, a recognition application under chapter 15 may be filed in relation to the English scheme of arrangement in relation to Stella.

In order to obtain recognition, the foreign representative must establish that a foreign court or administrative proceeding with respect to the debtor is pending and the foreign representative is empowered to act by the proceeding. If the representative can satisfy the above requirements, the scheme could be recognised. Schemes of arrangement have been granted recognition previously as having met the definition of foreign proceeding under the Bankruptcy Code.

Foreign main or non-main

Whether the proceeding is recognised as Foreign main or non-main will depend on where its COMI is located. [1a70]

In the US, a debtor's COMI is presumed to be its place of incorporation [1a71]. Accordingly, the fact that Stella is incorporated in France would create a rebuttable presumption that England is not the COMI, such that the scheme would likely be recognised as non-main foreign proceeding [1a72]. The fact that Stella's headquarters are located in Paris would also weigh in favour of France being the COMI rather than England. [1a73]

Further, the fact that Stella's products are made in Italy also suggest that England is not the COMI.

However, the fact that the loan and Eurobonds are governed by English law would weigh in favour of England being the COMI.

The location of the Eurobond issuer and bank that provided Stella with the loan, as majority creditors, will also impact the analysis. However, it is not clear on the facts exactly where either is located.

On the facts provided, it is likely the presumption that France is the COMI would not be rebutted such that the scheme of arrangement commenced in England would be recognised as a foreign non-main proceeding. The result may differ if the Eurobonds issuer and the bank that provided the loan are located in England.

**Question 4.3** [la74][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?**

*The license to manufacture Xblox is not an executory contract. Presently, Gamemart pays ToyCo monthly royalties and ToyCo is permitting the exclusive manufacture of Xblox. Accordingly, there is no underperformance [la75] of the contract by either party which would indicate the contract is executory.*

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

*GameMart may not transfer the license as part of a 363 sale without ToyCo's consent. [la76] Licensees of patents owned by debtors are protected under s 365(n) of the Bankruptcy Code such that consent is necessary [la77].*

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

*The contractual limitation requiring consent to assign the lease would be abrogated by the Bankruptcy Code [la78] if transfer of the lease would enable GameMart to achieve a higher value for the Factory than if the assignment limitation was enforced. In those circumstances, GameMart may transfer the factory lease as part of a 363 without Land Corp's consent. [la79]*

\* End of Assessment \*