



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**

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

Commented [la2]: Total marks 9/10

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**

Commented [la3]: Correct, 1 mark

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**

Commented [la4]: Correct, 1 mark

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

Commented [la5]: Correct, 1 mark

*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

Commented [la7]: Correct, 1 mark

*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]

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**Question 2.1** (1 mark)

Commented [la14]: Total marks 1/1

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

*Setoff is a mechanism which allows a creditor holding a claim against a debtor and who also owes the debtor to net out the two obligations. The Bankruptcy Code exempts the use of setoffs as it can improve the position of the creditor as opposed to other unsecured creditors.*

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Commented [la16]: Correct, 1/2 mark

**Question 2.2** [2 marks]

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

*The Bankruptcy Rules, the Federal Rules of Civil Procedure, local rules of the particular bankruptcy court and any personal practices issued by the particular judge should be reviewed and considered.*

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Commented [la21]: Correct, 1/2 mark

**Question 2.3** [2 marks]

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

*The absolute priority rule provides that under a plan of reorganization no creditor or class of creditors may receive less than it would be paid in accordance with statutorily required priorities. Payment in full must be made to each category of claims before the next category receives their payment.*

Commented [la23]: Correct, 1 mark

*While in a Chap 7 deviation is not permitted, in a Chap 11 plan, an affected creditor can consent to the deviation. In a Chap 11, a senior creditor may consent to a deviation if receiving less if distribution of the funds to lower priority claimants is necessary to obtain approval of the reorganization plan.*

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Commented [la25]: Correct, 1/2 mark

**Question 2.4** [2 marks]

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**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 on property which is senior to an existing lien or the same priority to the existing lien. A priming lien which requires court approval may be granted if the debtor can show that the interest of the secured creditor being primed is adequately protected. The court will also consider whether any other source of funds*

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Commented [la28]: Correct, 1/2 mark

are available which does not include a priming lien and whether the additional credit being made available to the debtor is substantial.

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Question 2.5 [3 marks]

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**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 transfer is where 90 days prior to a petition date, a debtor transfers its property to a creditor which exceeds the amount that the creditor would receive in a Chap 7 liquidation. The property must be returned to the debtor as per 11 USC, §547.

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There is no requirement to show fault of either the debtor or the creditor and there is also no penalty other than the return of the property. The purpose of preference transfer is to maintain an equal playing field among the creditors in the same group.

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The elements of a preference transfer claim are:

- A transfer of interest of the debtor in property;
- Transfer was to or for the benefit of the creditor;
- The debt was pre-existing;
- Transfer occurred when the debtor was insolvent;
- Transfer was done 90 days prior to a petition date; and
- The creditor received more from the transfer than they would in a Chap 7 liquidation.

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Commented [la34]: Correct, 1/2 mark

Commented [la35]: Specifically the transfer must have been on account of the pre-existing debt

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

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Question 3.1 [3 marks]

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**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 judge under the referral statute is allowed to hear and make determinations of only core proceedings. While a bankruptcy judge may hear a non-core proceeding if it is sufficiently related to a bankruptcy proceeding, the judge can not make a final determination. The judge is required to submit the proposed findings of fact and conclusions of law to the district court for a final decision as per 28 USC, §157(c). The bankruptcy court determines its power and jurisdiction at the start of the hearing of any motion or pleading by requiring the parties to inform the court whether the issue at hand is core or non-core.

Commented [la38]: This is limited by the holding in Stern v. Marshall to core proceedings that do not overlap with Article III jurisdiction, leaving proceedings that are specific to the Bankruptcy Code, such as a challenge to a petition. The bankruptcy court also may issue a final ruling with the parties' consent.

Commented [la39]: Correct, 1 mark

The referral statute provides for a district court at its discretion to withdraw the reference of its jurisdiction to the bankruptcy court. If the proceedings involves



*substantial questions related to federal statutes other than the Bankruptcy Code, the withdrawal of the reference is mandatory.*

*Bankruptcy court orders can be appealed by anyone who has standing. A final order is one that resolves all the issues in their entirety while an interlocutory order only resolves some of the issues. Final orders from the Bankruptcy court can be appealed as of right while interlocutory orders can only be appealed with leave of the appellate court. 28 USC, § 158(a)(2) provides that in Bankruptcy court an order extending the period of exclusivity to a propose plan are appealable as of right. In Bullard v Blue Hills Bank, the Supreme Court held that a bankruptcy order resolving a discrete dispute is a final order for the purpose of an appeal.*

*Appeals from the Bankruptcy court are usually heard by the district court for the district in which they sit. The BAP in certain circuits hears bankruptcy appeals, the parties have the option to request that the appeal be heard by the district court in these circuits. Parties have a further right of appeal to the circuit court of appeals and in rare cases an appeal from the bankruptcy court may go directly to the court of appeals.*

*Where the bankruptcy court in a core proceeding had the authority to enter a final order, the district court or BAP reviews the conclusions of law de novo and findings of fact and conclusions of law. Where the bankruptcy court in a noncore proceeding or didn't have authority to enter a final order, the district court or BAP reviews de novo all findings of fact and conclusions of law to which the party objected to. The order of a the district court or BAP would be reviewed by a circuit court of appeal de novo as to conclusions of law and for abuse of discretion for findings of fact.*

**Question 3.2** [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 the granting of a Chap 15 petition, recognition of a foreign main proceeding, a stay of creditor action is invoked. The stay is however, limited to the debtor's property within the jurisdiction of the U.S. as per 11 USC, § 1520(a)(1). At the Bankruptcy Court's discretion, a stay or other assistance may be granted on an interim basis pending recognition or following recognition of a non-main proceeding.*

*A foreign main is proceedings commenced in the debtor's COMI. Though rebuttable, a debtor's COMI is presumed to be its place of incorporation. Proceedings in a jurisdiction other than the debtor's COMI can be recognized as a non-main proceedings only if the debtor had an establishment in the jurisdiction prior to the commencement of Chap 15 proceedings. In Bear Stearns the Bankruptcy Court held that a Cayman was not the COMI of a Cayman incorporated exempt company because the company's licensed is on the basis that it will not have operations in Cayman. The*

**Commented [la40]:** Correct, 1/2 mark

**Commented [la41]:** Correct, 1/2 mark

**Commented [la42]:** Total marks 2.5/3

**Commented [la43]:** Correct, 1/2 mark, also the foreign representative can deal with the debtor's property in the ordinary course and seek approval to sell assets outside the ordinary course

COMI is assessed as the date of the US petition rather than the commencement of the foreign proceedings as a result of Bear Stearns.

Upon recognition of either foreign main or non-main proceedings the following discretionary relief may be granted:

- a. Authorization of discovery regarding the debtor's assets and affairs;
- b. Extension of provisional relief;
- c. Entrusting administration of the debtor's US assets to the foreign representative or other person; and
- d. Any other relief necessary to effectuate the purposes of Chap 15 and to protect the assets of the debtor or the interest of the creditor.

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Commented [la45]: Correct, 1/2 mark

Commented [la46]: Correct, 1/2 mark

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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?

Directors in Delaware owe a fiduciary duty of loyalty to the corporation's best interest and a duty of care in educated decision-making. These duties are owed to the corporation and its shareholder whether the corporation is solvent or potentially insolvent. A Delaware director does not owe any duty to a creditor even when the corporation is indeed insolvent as per *North Am Catholic Educational Programming Foundation, Inc v Gheewalka*.

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Commented [la50]: Correct, 1 mark

Commented [la51]: Correct, 1 mark

The business judgment rule protects directors from liability for errors of judgment. The board of directors is presumed to have acted in good faith on the basis of reasonable information under the business judgment rule. Unless the presumption is rebutted, in the absence of gross negligence, the directors will not be liable. If it can be shown that a majority of the board were not reasonably informed, did not have an honest belief that their decision was in the corporation's best interest or were not acting in good faith, the presumption can be rebutted. The business judgment rule however, does not apply to a transaction that was approved by a majority of the board that is not disinterested and independent or a controlling shareholder is on both sides of the transaction. Unless the entire fairness standard is satisfied, the transaction would be void.

Commented [la52]: Correct, 1 mark

A corporation's certificate of incorporation may also exculpate a director from liability for a breach of the duty of care but not a breach of the duty of loyalty as per *Del Gen Corp L, § 102(b)(7)*.

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.

11 USC, § 303 provides for the commencement of an involuntary proceeding under Chap 7 or Chap 11. The claim must satisfy the below to qualify as a petitioning creditor:

- a. The claim must not be contingent whereby it is dependent on the occurrence of a future event. An unmatured debt is not contingent if all requirements for liability have occurred except for the passage of time.
- b. A bona fide dispute must not exist as to the amount of the liability. A bona fide dispute exist where there is a reasonable basis for a dispute as to matter of law or fact. If a portion of the claim is disputed the petitioning creditor cannot use the undisputed amount to meet the threshold of US\$16,750.
- c. The claim must be unsecured or under secured, and amount to at least US\$16,750 separately or in in total with the other petitioning creditors.

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Commented [la56]: Correct, 1 mark

Commented [la57]: Correct, 1/2 mark

Commented [la58]: Correct, 1/2 mark

Commented [la59]: Correct, 1 mark, also the creditor must allege that the debtor is not paying its debts as they come due or has had a custodian appointed

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

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Question 4.1 [5 marks]

Commented [la61]: Total marks 3/5

*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?*

*Upon the filing of the petition by Speculation Inc, an automatic worldwide stay will come into effect. The automatic stay is very broad and applies to interference with the estate's property anywhere in the world. The automatic stay will have the following effect:*

Commented [la62]: Correct, 1 mark

- i) DOJ investigation - the stay will not have an effect on the investigation as it is subject to a statutory exception.
- ii) margin loan default - the automatic stay would apply as this would be a pre-petition litigation claim.

Commented [la63]: Correct, 1 mark

Commented [la64]: Incorrect, the margin loan is a securities contract and therefore exempt from the automatic stay, so the broker can sell the collateral and apply the proceeds to the loan balance

iii) **delinquent lease - eviction of a debtor-tenant from a non-residential property where the lease has expired is subject to a statutory exception. The stay will not have an effect.**

**Commented [la65]:** Incorrect, here the only default is failure to pay rent. Eviction is barred by the automatic stay unless the lease expired by its terms prior to the bankruptcy filing.

iv) **employment discrimination lawsuit - the automatic stay would apply as this would be a pre-petition litigation claim.**

**Commented [la66]:** Correct, 1 mark

**Any act in violation of the automatic stay constitutes a contempt of court and is void or voidable. An interested party may however seek to lift the stay.**

**Question 4.2 [5 marks]**

**Commented [la67]:** Total marks 3/5

**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 English scheme of arrangement can be recognised under chapter 15 of the Bankruptcy Code. Chapter 15 created an ancillary proceeding which is a new type of US proceedings as the US will not exercise jurisdiction or authority over the entire estate. The US will provide assistance to the English foreign proceedings. Reciprocity is not required as the US will recognise the English proceedings even if England would not recognise US proceedings. The foreign representative must establish that a foreign court or administrative proceeding in respect to Stella is pending and that foreign representative is empowered to act.**

**A foreign main is proceedings commenced in the debtor's COMI. Though rebuttable, a debtor's COMI is presumed to be its place of incorporation. Proceedings in a jurisdiction other than the debtor's COMI can be recognized as a non-main proceedings only if the debtor had an establishment in the jurisdiction prior to the commencement of Chap 15 proceedings. In Bear Stearns the Bankruptcy Court held that a Cayman was not the COMI of a Cayman incorporated exempt company because the company's licensed is on the basis that it will not have operations in Cayman. The COMI is assessed as the date of the US petition rather than the commencement of the foreign proceedings as a result of Bear Stearns. The recognition will be a foreign main proceedings as England can be considered Stella's COMI given that it is the jurisdiction whose law will apply.**

**Commented [la68]:** Correct, 1 mark

**Commented [la69]:** Correct, 1 mark

**Commented [la70]:** Correct, 1 mark, here the English proceedings could be recognized as foreign non-main because of the retail store in England

**Commented [la71]:** Incorrect, where the company's headquarters is in the same jurisdiction as its incorporation the presumption is very unlikely to be rebutted.

**Question 4.3 [5 marks]**

**Commented [la72]:** Total marks 1/5

**ToyCo is an American toy company that has created a popular line of folding robot toys called Xbox. The toys are covered by several US patents. Currently, GameMart Inc (GameMart) has a 10-year exclusive license to manufacture Xbox 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 Xbox 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?**

**If GameMart filed a Chap 11 bankruptcy it will have the ability to assume, reject or assume and assign executory contracts pursuant to § 365 of the Bankruptcy Code. A contract is considered executory if there are material underperformed obligations on both sides. Yes, this contract is executory.**

**Commented [la73]:** Correct, 1 mark

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

Yes it can.

**Commented [la74]:** Incorrect, consent is required by substantive intellectual property law which permits a licensor to refuse assignment of a license

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

No, it cannot.

**Commented [la75]:** Incorrect, the anti-assignment provisions of the lease are invalidated by the Bankruptcy Code

\* End of Assessment \*