



**38/50 = 76%**

**SUMMATIVE (FORMAL) ASSESSMENT: MODULE 3A**

**RESIT ASSESSMENT: SEPTEMBER 2023**

**THE INSOLVENCY SYSTEM OF THE UNITED STATES**

***This is the summative (formal) assessment for Module 3A of this course.***

***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. The final submission date for this assessment is 21 September 2023. Please provide the completed assessment back to Sanrie Lawrenson via email at [Sanrie.Lawrenson@insol.org](mailto:Sanrie.Lawrenson@insol.org) by no later than 23:00 (11 pm) GMT on 21 September 2023. No submissions can be made after this time, no matter the circumstances.**
- 6. When submitting your assessment you will be required to confirm / certify via email 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.**

**ANSWER ALL THE QUESTIONS**

QUESTION 1 (multiple-choice questions) [10 marks in total] **6 marks**

**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

**Car Corp, incorporated and headquartered in Michigan, owes Parts Inc, incorporated and headquartered in Mexico, USD 10,000 on a past-due invoice for components used to build Car Corp vehicles. May Parts Inc file an involuntary petition to place Car Corp into chapter 11 bankruptcy proceedings?**

- (a) Yes, regardless of the circumstances.**
- (b) Yes, if Car Corp has fewer than 12 non-contingent, non-insider creditors.**
- (c) Yes, if other creditors owed at least USD 5,775 join in the petition.**
- (d) No, because Parts Inc does not know whether Car Corp is insolvent.**
- (e) No, because Parts Inc is not a US company.**

Question 1.2

**Answer this question with reference to the set of facts set out in question 1.1 above: Which of the following is likely to be a party in interest in the bankruptcy of Car Corp?**

- (a) A shareholder in Parts Inc, to which Car Corp is indebted.**
- (b) A journalist writing about Car Corp's bankruptcy.**
- (c) A shareholder in Investment Corp, Car Corp's parent company.**
- (d) A retired employee of Car Corp who receives payments from the company's pension plan.**

**(e) A non-profit organization that advocates for companies like Car Corp to be held responsible for climate change**

Question 1.3

**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) Options (a) to (c) above satisfy the minimum requirement for presence in the United States.**

**(e) None of the above (options (a) to (d)) satisfy the minimum requirement for presence in the United States.**

Question 1.4

**Who may serve as a foreign representative to seek recognition of a foreign proceeding under chapter 15?**

**(a) An officer of the debtor if it is a debtor-in-possession in the foreign proceeding.**

**(b) The board of directors of the debtor if it is a debtor-in-possession in the foreign proceeding.**

**(c) An insolvency professional appointed by the court overseeing the foreign proceeding.**

**(d) An insolvency professional appointed by a creditor where the foreign proceeding is an involuntary receivership.**

**(e) All of the above.**

Question 1.5

**Which of the following regarding executory contracts is false?**

**(a) A court will generally defer to a debtor's business judgment regarding whether to assume or reject an executory contract.**

- (b) Executory contracts are clearly defined by the Bankruptcy Code.**
- (c) In the most common formulation, executory contracts are defined as those where both sides to a contract have material unperformed obligations.**
- (d) Chapter 11 debtors have greater flexibility than chapter 7 debtors on when they may assume, assign or reject an executory contract.**
- (e) Under the hypothetical test, a debtor cannot assume an executory contract if the debtor could not also assign the contract.**

Question 1.6

**Which of the following is not a requirement to confirm a “cramdown” plan?**

- (a) That the plan is fair and equitable to dissenting classes of creditors.**
- (b) Acceptance of the plan by at least one class of impaired, non-insider creditors.**
- (c) Acceptance of the plan by all classes of secured creditors.**
- (d) That the plan does not discriminate unfairly against dissenting classes of creditors.**
- (e) That the dissenting creditors receive no less than they would under a liquidation scenario.**

Question 1.7

**Which of the following statements about “pre-packs” is false?**

- (a) A pre-pack cannot be used if the debtor wishes to reject executory contracts.**
- (b) Creditors must have sufficient information about the debtor and the plan to make an informed voting decision.**
- (c) A pre-pack debtor may spend as little as a single day in bankruptcy.**
- (d) The proposed plan of reorganization is submitted to the bankruptcy court together with the voluntary petition.**
- (e) Creditors’ commitment to vote in favor of the plan may be memorialized in a restructuring support agreement.**

Question 1.8

***If a debtor rejects an executory trademark license agreement under which the debtor licenses its trademark to a manufacturer, which of the following is true:***

- (a) The manufacturer has a claim for damages for breach of contract.***
- (b) The manufacturer must immediately stop using the trademark.***
- (c) The manufacturer can continue using the trademark for the remaining period of the license.***
- (d) Both options (a) and (b).***
- (e) Both options (a) and (c).***

Question 1.9

***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 1.10

**Which of the following regarding substantive consolidation is true?**

- (a) ***It respects the boundaries of corporate separateness.***
- (b) ***If a creditor can show it extended credit on the basis of corporate separateness, it has a valid objection to substantive consolidation.***
- (c) ***It is the treatment of two or more creditors as a single creditor to simplify the claims process.***
- (d) ***Substantive consolidation is commonly used to resolve bankruptcies of corporate groups.***
- (e) ***Authority for substantive consolidation comes from the Bankruptcy Code.***

QUESTION 2 (direct questions) [10 marks]

Question 2.1 (1 mark) **1 mark**

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

**ANS:**

Set off permits a creditor holding a claim against the debtor and simultaneously owing money to the debtor to net out the two, or more obligations. These rights can improve the position of the creditor as compared to other unsecured creditors who are not owed money by the debtor. This allows both the entities to apply their mutual debts against each other thus avoiding A paying to B when B owes A, keeping in all fairness in mind.

Generally, Courts have disallowed otherwise valid setoff in two kind of cases i.e

- a) Where creditor committed illegal or fraudulent act or set off is against public policy. The policy reason for disallowing is that it results in different treatment to similarly situated creditors.
- b) Where it would significantly harm the debtor's ability to reorganize.

Question 2.2 [2 marks] **2 marks**

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

**ANS:**

When a company has filed for Bankruptcy under chapter 11, the debtor in possession may resort to Priming lien when it is unable to obtain any other financing. If the existing lenders consent to or the debtor is able to show that the creditors will be adequately protected by the value of their collateral.

Such incentives are provided to lenders by the Bankruptcy code. The court may grant such Priming lien which may be senior or equal to lien available at the Pre-petition time. This may have priority over pre bankruptcy secured lenders and also over administrative expenses. Priming loan can help in reorganizing and maintaining business. The existing lenders may agree to being primed i.e when they believe that this will help the company to recover and eventually pay off debts. Such financing is given a priority status. They receive lender protections not available otherwise. It is a safeguard to the existing loan. Thus, such DIP financing is a relatively safe investment. The lender is protected from effects of reversal order on appeal.

**Question 2.3 [2 marks] 2 marks**

***What are two potential consequences of a violation of the automatic stay?***

Ans:

The automatic stay stops creditors from collecting debts from the debtor. This is until the court proceedings are completed. The stay comes into effect as soon as the petition is filed. If debtor's assets are likely to lose value significantly, Creditors may apply requesting the court to lift the automatic stay.

An act of violation of such a stay may constitute Contempt of Court. This may be considered void or voidable depending on where the proceedings are pending.

The automatic stay puts the creditors on a level playing field. The refusal of lifting of stay may result in the imposition of sanctions against the violator. This can be in the form of payment of debtor's Attorneys Fee etc and also require the violator to act promptly to undo the effect. The relief sought for lifting of stay may be considered in certain circumstances like no provision for adequate protection to the creditor or the court finds that the debtor's filing a petition was with a motive to delay or defraud the creditors.



Question 2.4 [2 marks] **2 marks**

***In voting on a plan of reorganization, which class(es) of creditors are (i) deemed to accept the plan, (ii) deemed to reject the plan and (iii) permitted to vote on the plan? What vote is necessary for a class of creditors to accept a plan?***

ANS:

An unimpaired class is deemed to accept the plan. This includes those whose acceleration of debt has been reversed.

The class that will receive nothing is deemed to reject the plan.

Bankruptcy Code specifies requirements of a plan for a corporate debtor. It also specifies additional items that may be included in a plan.

Designation of classes of claims or interests held by creditors. The classes would be

(a) creditors secured by real property, (b) creditors secured by personal property, (c) unsecured creditors and (d) shareholders (equity). Specify classes are unimpaired and which are impaired.

Only impaired classes have the right to vote on the plan.

Balance of decision-making power lies with those who have gain the most or lose out of the impaired classes.

As only one consenting impaired class is required, class definition can become conflicting.

A non-insider with an impaired claim who supports the plan, if classified into a one-creditor class, can invoke cramdown of all other dissenting creditors. The dissenting creditors, may challenge the reasonable basis for the separate classification that creditor.

Question 2.5 [3 marks] **3 marks**

***Answer the following questions about preferences, actual fraudulent conveyances and constructive fraudulent conveyances:***

***(a) Which cause of action applies only to transfers made on account of antecedent debt?***

***(b) Which cause of action requires that the debtor be presumed or proven to have been insolvent at the time of the transfer?***

**(c) Which cause of action requires that the debtor be proven to have intended to frustrate creditors' recoveries?**

ANS:

- (a) A transfer of debtor's property, made in the suspect period before the petition date is a preference. If this exceeds the amount the recipient would have received in a chapter 7 liquidation, had the transfer not been made, must be returned to the estate. Such avoidance of preferences under s.547 is with the intent to equalize treatment of similarly situated creditors and thus disincentivize the creditors for such collection.

One of the elements of preference claim are for or on account of an antecedent debt owed by the debtor before such transfer was made, for the benefit of the creditor. A contemporaneous exchange of value is not a preference.

- (b) The company can be insolvent before filing for insolvency. The payment made is a preference payment when the debtor was insolvent.

The debtor is automatically presumed to be insolvent during the 90 days before bankruptcy, but the transferee may present evidence to rebut that presumption. Creditor's lack of knowledge is no defence. Balance sheet test whether the debts exceed the assets as also the date on which the transfer is made are taken into account.

- (c) Preference avoidance is aimed largely at transactions immediately prior to bankruptcy, other transactions to be avoided are fraudulent conveyances or constructive fraudulent conveyances (not showing fraudulent intent)

An actual fraudulent conveyance is shown by actual intent to delay, or defraud any entity to which the debtor was or became indebted (anticipated liability). The intent is proved circumstantially. This is shown when the transfer is done to an insider, the debtor retained possession or control of the property transferred after the transfer, transfer was concealed, the debtor was insolvent or became insolvent shortly after transfer, received a value not matching the value of the asset.

A constructive fraudulent conveyance can be proven by showing that the debtor received less than reasonably equivalent value in exchange for a transfer. At such time the debtor was insolvent, unreasonably undercapitalised, intended to incur debts beyond its ability to repay, transfer made for the benefit of insider.

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

Question 3.1 [3 marks] **3 marks**

***Describe the circumstances in which a bankruptcy court may enter a final order consistent with the US Constitution, who reviews appeals from bankruptcy court orders and how orders that are not constitutionally final are reviewed.***

ANS:

Final orders are those that dispose of all issues, leaving nothing further to be decided, whereas interlocutory orders resolve only some issues or claims.

As a right the final orders may be appealed. Interlocutory orders may be appealed only with leave of the appellate court. The distinction between interlocutory and final orders can be an elusive in Bankruptcy proceedings.

The US Supreme Court has held that a bankruptcy order resolving a discrete dispute is a final order for purpose of appeal. (*Bullard v Blue Hills Bank*)

For purposes of appeal, the order passed by Bankruptcy court if it does not resolve the entire issue in dispute is not final even when order is constitutionally final. If the parties have not consented to the bankruptcy court's jurisdiction, would be final for purposes of appeal may not be final in the constitutional sense.

The District Court for the district hears the appeals from Bankruptcy Court decisions. In certain circuits bankruptcy appeals are heard by Bankruptcy Appellate Panel (BAP). This is convened by judges of the bankruptcy courts within the circuit. However the party has the option to make a request for hearing to be done before the District Court. From the district court or BAP, there is a further appeal of right to the circuit court of appeals. An appeal from a bankruptcy court may go directly to the court of appeals in cases where there is question of law is raised and certified by the District court, which has not been resolved or raises conflicting decisions regarding that issue. The court of appeals has discretion whether to accept a case so certified.

The order of a district court or BAP is reviewed by a circuit court of appeal *de novo* as to conclusions of law and if there has been any of discretion for findings of fact.

If the order was in a core proceeding over which the bankruptcy court had authority to enter a final order, the district court or BAP reviews conclusions of law. It also reviews findings of fact for abuse of discretion, in view of the bankruptcy court having greater opportunity to look into the evidence. If the ruling was in a non-core proceeding or the bankruptcy court otherwise did not 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 a party has objected.

A counterclaim is a core proceeding according to the provision of S 157, to which a bankruptcy court can issue a final order. The US Supreme Court held that when the bankruptcy court issues a final order over a state law claim, it would be unconstitutional under Article III. The US Supreme Court has held that bankruptcy judges may determine a core proceeding over which they lack constitutional authority by issuing a report for review by the district court. (*Executive Benefits Ins Agency v Arkison*) On June 9, 2014, the Supreme Court issued its opinion in *Executive Benefits Insurance Agency v. Arkison*

**Question 3.2 [3 marks] 3 marks**

***What provisions of the Bankruptcy Code may not be invoked by a foreign representative in a chapter 15 proceeding? What are two ways that the foreign representative can obtain equivalent relief?***

ANS:

In 2005, the US adopted the UNCITRAL Model Law on Cross-Border Insolvency nearly verbatim, as chapter 15 of the Bankruptcy Code. This created a new type of US bankruptcy proceeding which is an ancillary as opposed to plenary proceeding. US does not exercise jurisdiction or authority over the entire estate but rather provides assistance to the foreign proceedings concerning the debtor. There is no reciprocity of treatment required.

International comity is an integral feature of chapter 15.

The filing of a petition is done by the foreign representative of the debtor. An automatic stay on creditor action is not invoked. The stay comes into being only if the Petition is recognised as foreign main proceeding. Petition may be refused recognition or assistance where if it is contrary to US public policy, though this is rare. Foreign main proceedings are those that are commenced in the debtor's center of main interests (COMI). COMI is a concept foreign to

US law. There are certain reliefs available when the proceeding is recognised as foreign main proceeding. Certain discretionary relief is sought in a foreign non-main proceeding. This step may be taken to obtain access to the Bankruptcy Code's avoiding powers.

The Model law addresses Article 23, the powers granted to a foreign representative on recognition of a foreign proceeding with respect to avoidance actions i.e it excludes from the rights granted to foreign representatives the use of avoidance powers provided by the Bankruptcy code. Foreign representative can only invoke the Bankruptcy Code avoidance powers in a plenary proceeding such as chapter 7 or 11.

In the matter of Trikona(TAL) Chapter 15 was an issue because the litigant involved sought a U.S. court's recognition of, and deference to, the findings of a non-U.S. insolvency court. The litigant was not a foreign representative seeking recognition of a foreign proceeding also the enforcement of a foreign insolvency court's order. Here chapter 15 did not apply.

Another important issue in this judgement was that a foreign representative may file a chapter 15 case on behalf of a foreign debtor in the U.S. as a means of gaining access to U.S. court. The purpose would be of attempting to enforce a judgment of a foreign court presiding over the debtor's insolvency proceedings. Though this may not always be the case.

**Question 3.3 [4 marks] 4 marks**

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

ANS:

The Bankruptcy Rules -Procedures in bankruptcy proceedings are governed by the Federal Rules of Bankruptcy. These frequently incorporate by reference the Federal Rules of Civil Procedure, more with respect to litigation of disputed issues in matters which are contested.

In addition, each bankruptcy court will have local rules of procedure, and personal practices are issued by each judge. These are available on the website and are updated periodically. The local rules and practices contain the working procedures which are preferred by the judges. The deadlines for filing and submission of pleadings are mentioned therein. Thus in a nutshell Bankruptcy rules, the Federal Rules of Civil Procedure ,local rules of the court and

personal practices of the judges are to be taken care of when preparing a filing for a Bankruptcy Court. If one is not a regular practitioner, advice may be taken by consulting a local practitioner to be aware of unwritten local practices.

**Question 3.4 [5 marks] 5 marks**

***What fiduciary duties do directors of Delaware corporations owe and to whom are the duties owed in the ordinary course of business? To whom are duties owed when the corporation is potentially or actually insolvent?***

ANS:

US director liability is limited as compared to other jurisdictions. Delaware is known to be a pre-eminent jurisdiction for corporate law.

According to the Delaware Secretary of State's Division of Corporations, over two-thirds of all Fortune 500 companies, and 1.3 million companies total, are incorporated in Delaware as of 2018. Many other US states have modeled their corporate laws on Delaware's legislation.

Fiduciary duties of the directors of Delaware corporations are based on principles of care and loyalty. These include good faith, oversight and disclosure.

Duty of care would involve informed decision based on the material available.

Duty of loyalty as the word means is to act honestly in the best interest of the company. At the same time they have to consider interest of the shareholders and the company together. They owe a duty of taking care that educated decisions are taken in the interest of the company. Protection is provided to them under business judgement Rule, under which it is presumed that the directors have acted in good faith.(BJR). This presumption can be rebutted by showing that a majority of the board were not reasonably informed. The directors are not made liable in the absence of gross negligence.

BJR is rebuttable presumption and the directors act in accordance with their fiduciary duty. The burden is on the plaintiff to present evidence of their gross negligence or motivated by those other than stock holders as a whole. The court has to make a finding that the decisions were non rational decisions.

Protection permitted to for the directors are as under:

\*Delaware law provides for defending against claims of breach of duty by them.

\*Reliance is made on company records.

\*In the certificate of incorporation an exculpation provision is incorporated for Delaware corporations.

\*Indemnify the directors and advance their expenses within some limitations.

\*Delaware corporations are permitted to purchase liability insurance for directors and officers.

\*Directors duties are owed to the corporation and its shareholders and not to creditors.

The Delaware Supreme court in the matter of Gheewala has put to rest any such conclusion that the directors owe duties to the creditors, when a company is insolvent or potentially in such a zone.

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

##### Question 4.1 [5 marks] **2 marks**

***iWork Ltd leases office space from office building owners and sublets the space to small businesses. Due to the increases in the numbers of businesses operating remotely, iWork Ltd has suffered a decline in revenues. As a result, it has failed to pay rent on some of its office space leases. What protections does the Bankruptcy Code provide to lessors of office space to iWork Ltd?***

ANS:

A debtor is protected by the automatic stay from most creditor actions. Once the tenant files bankruptcy, a lessor may not demand rent, terminate a lease or file for eviction. In chapter 11, debtor will be given time to assume or reject a lease. **120 days** Unless an extension is granted, lease is deemed rejected. **90-day extension for cause, but not further without lessor consent.** If assumed the debtor is required to cure default of payment of obligation of pre-bankruptcy. If the lease is rejected the landlord receives the premises. He has the right to assert as unsecured claim. If the debtor takes time for electing either to assume or reject, Bankruptcy Code provides that the debtor-tenant is required under a commercial lease to timely perform all the obligations of the debtor. There have been varied observations by the courts in regard to timing and nature of obligations.

There is a difference that exists between the vendors doing business with a debtor and the lessor. Unlike vendors who can elect to stop doing business with a debtor, a lessor has to generally continue with the lease obligations unless the debtor opt to reject the lease. Lessors come into a position which is difficult post-bankruptcy. Remedies are available when a debtor assumes its lease. Bankruptcy code does not provide specific remedies when the debtor fails to honor the lease. Lessors have a difficult situation.

It has been seen in cases that the lessor is left with the option to fight for Administrative priority claim = **Administrative priority treatment for 2 years of rental payments for leases that**

**are assumed and subsequently rejected.**.. This is under the ambit of S. 503(b) of the code, though this is not an attractive proposal. Legal costs may be huge and also there may be risk that the debtor's assets are insufficient to pay all of the administrative claims. Another risk involved would be where the debtor converts to chapter 7. The lessor might be better placed if it moves the bankruptcy court to enforce the provisions of sections 365(d)(3) early in the case.

The Imperial Beverage case court noted that remedies are available in the code when a debtor assumes a lease post -petition and not when debtor elects to reject the lease. The specific direction being not available, courts have taken different approach.

An increased amount of time is provided to the lessee or the debtor to assume or Reject a Non-residential lease as per S. 365(d)(4)

***iWork must pay rent as an administrative expense for the period prior to rejection of a lease. [but note Covid exception to this has developed in practice]***

***Lessors have a claim in the bankruptcy for unpaid pre-petition rent.***

Question 4.2 [5 marks] (1 mark)

***Skin Luxe is incorporated and has a principal place of business in France where it develops and manufactures high end skincare products. Skin Luxe sells its skin care products through its own boutiques in many international cities, including Paris, Las Vegas, London and Hong Kong. Skin Luxe's English law-governed bonds are due to mature in one year, but it is unable to repay or refinance them. Skin Luxe is considering using an English scheme of arrangement to restructure the bonds.***

***Discuss whether the English scheme of arrangement could be granted recognition under US chapter 15 as a foreign main or foreign non-main proceeding.***

ANS:

Filing of petition by foreign representative of the debtor can be commenced under chapter 15. This cannot be done involuntarily by creditor filing. This requires recognition and only after recognition, the stay comes into effect. The stay is limited to the property of the debtor within the territorial jurisdiction of the United States.

The requirement for recognition are that 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.

Prior to the recognition of a chapter 15 proceeding however, creditors may commence an involuntary chapter 7 or 11 proceeding against an entity that is in foreign bankruptcy proceedings. A foreign representative may seek dismissal of US plenary proceedings



against a foreign debtor only if the foreign proceeding is recognized under chapter 15 and the court concludes that the purposes of chapter 15 would be best served by dismissal.

At this stage the requirement is the characterization of the foreign proceedings as foreign main or foreign non-main proceedings. Foreign main proceedings are those that are commenced in the debtor's center of main interests (COMI). A debtor's COMI is presumed to be its place of incorporation, but this is rebuttable. Other factors to be analysed are :

- location of headquarters;
- location of management;
- location of primary assets;
- location of a majority of debtor's creditors or a majority of the creditors that will be affected by the relief requested by the foreign representative; and
- jurisdiction whose law will apply to most disputes

However US uses the concepts of domicile, principal place of business, and location of assets in determining jurisdiction and venue. In the given facts of the case the company Skin Luxe is incorporated and has a principal place of business in France.

Proceedings can be recognized as foreign non-main proceedings in a jurisdiction other than the debtor's COMI. Considering that the debtor had an establishment in the jurisdiction. Establishment would mean a place where it carried out non-transitory economic activity – prior to the proceedings under chapter 15.

Skin Luxe sells its skin care products through its own boutiques in many international cities, including Paris, Las Vegas, London and Hong Kong, thereby indicating economic activity being carried out prior to the chapter 15 proceedings.

In the Bear Stearns case, the US bankruptcy court held that the Cayman Islands could not be the COMI for a Cayman-incorporated hedge fund because the fund was an “exempt” company. It was licensed on the basis that it would not have operations in the Cayman Islands. The court also found that liquidation of Cayman could not be recognized as a non-main proceeding because the debtor could not show any establishment prior to its insolvency.

A foreign proceeding need not resemble a US bankruptcy case to be recognized. It has been defined in the code as: a collective judicial or administrative proceeding in a foreign country

under a law relating to insolvency in which proceeding the assets and affairs of the debtor are subject to control or supervision by a foreign court, for the purpose of reorganization or liquidation. Under this definition proceedings under English schemes of arrangement have been granted recognition, considering that it is not contrary to US public policy. Upon recognition of a foreign main proceeding, the debtor and the foreign representative automatically receive certain protections, including the benefits of the automatic stay.

The court has discretion to grant similar relief upon recognition of a foreign nonmain proceeding. However, court must determine the location of a debtor's COMI and/or establishment when ruling on a Chapter 15 petition. Facts in the given case present that Skin Luxe sells its products in different locations thus establishing the concept of establishment and would thus receive recognition of Foreign non main proceedings. (1)

***Application to facts required. Skin Luxe's COMI is France because it is incorporated and has a principal place of business there. Connections with other jurisdictions are not sufficient here to overcome the presumption in favor of the place of incorporation. Because the English scheme is not in the country of Skin Luxe's COMI, recognition as a foreign main proceeding is not possible. Skin Luxe operates a boutique in London so it has an establishment in the jurisdiction of the scheme proceeding.***

Question 4.3 [5 marks] **4 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 has been sued in civil suit 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 (i) the DOJ investigation, (ii) margin loan default; (iii) the delinquent lease and (iv) the employment discrimination lawsuit?***

ANS:

- (i) DOJ Investigation : The DOJ investigation would not be stayed under automatic stay upon filing of chapter 11 proceedings.

A component of the United States Department of Justice i.e. The United States Trustee Program seeks to promote the efficiency and protect the integrity of the Federal bankruptcy system. It also identifies and helps investigate bankruptcy fraud

and abuse in coordination with United States Attorneys, the Federal Bureau of Investigation, and other law enforcement agencies. One of the duties would be to ensure that all required reports and schedules are timely filed, and that the debtor manages money and assets consistent with the Bankruptcy Code and with its fiduciary duty to creditors. This would aid the ongoing DOJ investigation.

- (ii) Margin loan default: This contract is a securities contract that is exempt from automatic stay. The broker can sell the collateral to make good the loan default.

To maximize the chances of a successful reorganization, the Bankruptcy Code provision and incentives to lenders to extend credit to the debtor commonly referred to as debtor in possession (DIP) financing can be resorted to. This can help the debtor to rectify the loan default. An assurance and showcasing protection to the lenders may help him to come out from the Loan default.

- (iii) The delinquent lease : The automatic stay bars the landlord from commencing eviction petition. However the debtor may assume the lease and may be granted time to cure the default. If the debtor rejects it the lessor, lessor is left with the option to fight for Administrative priority claim.
- (iv) Employment discrimination law suit: This shall be stayed upon automatic stay till the Bankruptcy proceedings conclude.

***The filing of the chapter 11 would result in immediate application of the automatic stay.***

**\* End of Assessment \***