

TOTAL = 41.5/50
83%



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.***
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- 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 2024. The assessment submission portal will close at 23:00 (11 pm) GMT on 1 March 2024. 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 2024 or by 23:00 (11 pm) BST (GMT +1) on 31 July 2024. If you elect to submit by 1 March 2024, you may not***

submit the assessment again by 31 July 2024 (for example, in order to achieve a higher mark).

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

ANSWER ALL THE QUESTIONS

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

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

Question 1.1

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. [FV1]**
- (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. [FV2]**
- (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.^[FV3]

(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.^[FV4]

(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.** [FV5]
- (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.* [FV6]
- (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* [FV7] *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.*
- [FV8] (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.*
- [FV9] (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 [FV10] 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)

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

Setoff is a situation whereby a creditor is both indebted to the debtor whilst also having a claim against the debtor, and the two amounts are netted. Setoff can be a powerful tool in bankruptcies as it allows creditors to cancel out financial obligations if it does not think that the debtor will pay its outstanding debts. However, the debts need to be owed on the same side of the bankruptcy proceedings, i.e., either pre-petition or post-petition.¹ In accordance [FV11] with the US bankruptcy code, it is presumed that the debtor is insolvent for the 90 days before the petition², therefore it is important that the setoff claim is made as early as possible.

Setoff is not permitted in several circumstances because setting off the claim may put a particular creditor in a better position than other unsecured creditors, giving them an unfair preference. Applying setoff allows the creditor to receive full payment of their claim up to the amount of the setoff.

Question 2.2 [2 marks]

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

¹ Bankruptcy and Creditors' Rights: Your Guide to Setoff and Recoupment, Crawford & Von Keller
<https://www.crawfordvk.com/bankruptcy-and-creditors-rights-your-guide-to-setoff-and-recoupment/>

Accessed 22 February 2024

² 11 USC Code § 553 - Setoff

A priming lien is a superior lien on property, either surpassing or equal in priority to existing liens on the same property. Priming debtor-in-possession (DIP) financing is considered only as a final option when the debtor cannot secure any alternative financing (such as [FV12] unsecured loans on an administrative priority basis or non-priming DIPs). In such cases, the priming lenders must either consent, or the debtor must show that secured creditors are sufficiently safeguarded against the devaluation of their collateral due to the priming lien.

Question 2.3 [2 marks]

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

Violation of the automatic stay by another party results in a contempt of court which is punishable by the court. In these circumstances the debtor may recover damages including attorney's fees, costs and in some situations, punitive damages.³

[FV13]

Further to the above, should the court have concerns regarding the violator and potential further violations, the court can order coercive contempt sanctions against the violator. This may be in the form of daily fines, a compensatory fine, coercive incarceration, or may be a combination of these.⁴

Question 2.4 [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?

(i) *Deemed to accept the plan*

Creditors whose contractual rights are not adversely impacted by the proposed plan of reorganisation, i.e. an unimpaired class, are deemed to accept the plan.

(ii) *Deemed to reject the plan*

The class that doesn't receive anything is deemed to reject the plan.

(iii) *Permitted to vote on the plan*

The creditors that have the voting power in a plan of reorganisation is the class of creditors whose legal rights or interests are affected by the proposed plan, the impaired creditors.

[FV14]

(iv) *What vote is necessary for a class of creditors to accept a plan*

For the plan to be ratified, a simple majority of the class of creditors within the class, representing at least two-thirds of the total value of claims in the class, vote in favour.

³ 11 USC § - Automatic stay

⁴ USA v Ebony Scott et al. Order of Civil Contempt and coercive incarceration:

<https://www.justice.gov/archive/tax/Ordercont218.pdf> Accessed 22 February 2024

Alternatively, for equity interests, the plan is approved when at least two-thirds in value of the interests vote in favour.

Question 2.5 [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^[FV15] creditors' recoveries?**

(a) Preferences

(b) Preferences

(c) Actual fraudulent conveyance

QUESTION 3 ^[1a16](essay-type questions) [15 marks in total]

Question 3.1 ^[1a17][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.

Final Orders

A bankruptcy court has authority to issue final orders on core proceedings, which includes but is not limited to matters concerning the administration of the estate, orders in respect of obtaining credit and confirmation plans⁵. The bankruptcy court cannot make final determinations on non-core matters, being those not listed in the code as core. However, in 2011 in Stern v Marshall, it was held that bankruptcy courts can't issue final orders if it invades Article III jurisdiction, and this would therefore be ruled as unconstitutional. Following this controversial ruling, amendments were made to the Bankruptcy Rules to help to clarify the position. Bankruptcy courts can exercise a district court's delegated authority to make final orders for any motion challenging the validity of a bankruptcy petition.^[1a18] This is because exclusive jurisdiction is given to district courts in adjudication of petitions to commence bankruptcy proceedings. The US Supreme Court has also ruled that the bankruptcy courts can make final orders in respect of certain bankruptcy cases even whereby they

⁵ 11 USC Code 157(b)(2)

don't have constitutional powers⁶. In these circumstances, they may suggest a decision to the district court for review, or if all parties agree, they may make the final decision themselves⁷.

In relation to appeals however, a bankruptcy order is only final if the bankruptcy court had the authority to enter it, and it resolves the whole dispute. However, this order may not be constitutionally final unless all parties have consented to the bankruptcy court's jurisdiction.

Appeals

Appeals may be heard by the district court, a Bankruptcy Appellate Panel (BAP), or the court of appeal. An initial appeal is either heard in the district court in the district that it sits in, or in some circuits, the BAP. If assigned to a BAP, the party can instead opt to be heard by the district court. Whereby there is an appeal of right, the appeal may be heard by the court of appeal, or in very rare circumstances, the appeal can go straight to the court of appeal if certain conditions are met and proved by the bankruptcy or district court.

Review of orders

In situations whereby the final order is not constitutional, such as in non-core proceedings or whereby the bankruptcy doesn't have appropriate authority, the BAP or district court will reexamine the facts, evidence, and legal arguments presented in the case without relying on any earlier rulings. The court of appeals will also review the order of the district court or BAP in the same way.

Question 3.2 [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?

Avoidance powers provided by Article 23 of the Model Law on Cross-Border Insolvency Law⁸ (MLCBI) provides powers to a foreign representative to avoid certain actions which would be detrimental to creditors. Whilst the US is a MLCBI member state, it has not adopted these powers into its insolvency legislation in Chapter 15.

However, it is interpreted by some that the foreign representative may still seek avoidance of pre-petition transactions through application of domestic or foreign

⁶ Executive Benefits Insurance Agency v Arkinson, 134 S. Ct. 2165 (2014)

⁷ Wellness International Network Ltd v Sharif, 135 S Ct 1932 (2015)

⁸ UNCITRAL Model Law on Cross-Border Insolvency Law with Guide to Enactment and Interpretation, <https://uncitral.un.org/sites/uncitral.un.org/files/media-documents/uncitral/en/1997-model-law-insol-2013-guide-enactment-e.pdf> Accessed 25 February 2024

laws^[1a26] applicable to the circumstances, although this may be limited by the statute of limitations or situations whereby claims for constructive conveyance can't be applied.

Avoidance powers can also be applied by foreign representatives in Chapter 11 and Chapter 7 'plenary' proceedings.^[1a27] This may be in situations whereby the debtor or creditors commence proceedings before the appointment of the foreign representative or, less commonly, where the foreign representative may want to commence a Chapter 7 or 11 proceeding after seeking recognition through Chapter 15. The relief granted by Chapter 7 and 11 would be coordinated with the foreign representative and limited to the debtor's US assets.

Question 3.3^[1a28] [4 marks]

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

Bankruptcy Rules^[1a29]

It is firstly important to refer to the Bankruptcy Rules which govern procedures in bankruptcy proceedings. These were implemented by the Supreme Court in 1973, alongside the Official Bankruptcy Forms, which have both been amended many times since.⁹ Therefore, it is important to refer to the most recent Rules and Forms when preparing filings for the court.

Federal Rules of Civil Procedure^[1a30]

The Bankruptcy Rules often incorporate the Federal Rules of Civil Procedure. These are important in bankruptcy procedures in relation to litigious matters concerning adversary proceedings and contentious matters and should therefore be reviewed alongside the Bankruptcy Rules.

Local rules of the Bankruptcy Court^[1a31]

In addition to federal rules, each state will apply its own local rules in the bankruptcy court which may differ between courts. These are regularly updated, and one should refer to these on the website of the applicable bankruptcy court.

Judge's Personal Practices^[1a32]

Similarly with the local rules of the Bankruptcy Court, each Judge will have differing personal practices. Again, these will be updated periodically, and it is important to refer to the local bankruptcy court's website to confirm the current practices. Both

⁹ Federal Rules of Bankruptcy Procedure, <https://www.uscourts.gov/rules-policies/current-rules-practice-procedure/federal-rules-bankruptcy-procedure> Accessed 25 February 2024

these and the local rules of the bankruptcy court can affect deadlines required for filings and responses to pleadings, which can be critical to bankruptcy filings.

Aside from the above, it is important to research relevant case law for the application of the laws, and to consider retaining a US practitioner to provide guidance on any 'unwritten' rules.

Question 3.4 [1a33] [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?

*Directors of Delaware incorporated companies owe fiduciary duties of **care** [1a34] and **loyalty** [1a35] to the company's best interests. The duty of care means that the director should be making informed decisions, based on all reasonably acquirable information. The duty of loyalty requires that directors act in good faith and on a disinterested and independent basis and must honestly believe that the decisions made are in the best interest of the company.*

To be disinterested and independent requires that the director doesn't materially receive any benefit from matters in which decisions are being made, and that they don't have any close relationships with people or entities which may influence the outcome of decisions made.¹⁰ When reviewing decisions made by the board, Delaware courts will initially apply the Business Judgement Rule. Under this rule, as long as the majority of directors are disinterested and independent when the decision is made, and the directors have made the decision with due care and in good faith, it will not be questioned later by a court.¹¹ This is a key component of Delaware corporate law.

*Fiduciary duties in some states are subject to change when a company becomes insolvent. In Delaware, directors owe a duty of care to only the **shareholders** [1a36] of a company and the **company** [1a37] itself, whether the entity is solvent and operating in the ordinary course of business or approaching insolvency (in the zone of insolvency). When the company is in these states, creditors rights are instead protected by other laws, for example fraudulent conveyance laws or contract law. It was held in *North American Catholic Educational Programming v. Gheewalla*¹² that "When a solvent corporation is navigating in the zone of insolvency, the focus for Delaware directors does not change", meaning that their fiduciary duties are the same as pre-insolvency.*

¹⁰ Directors' Fiduciary Duties" Back to Delaware Law Basics, Skadden, Arps, Slate Meagher & Flom LLP and Affiliates <https://www.skadden.com/-/media/files/publications/2020/02/directorsfiduciarydutiesbacktodelawarelawbasics.pdf> Accessed 26 February 2024

¹¹ The Delaware Way: Deference to the Business Judgment of Directors Who Act Loyal and Carefully, Delaware Gov, <https://corplaw.delaware.gov/delaware-way-business-judgment/> Accessed 26 February 2024

¹² *North American Catholic Educational Programming v. Gheewalla* (Del. Supr. 2007)

When a company is actually insolvent, directors still have no duty to creditors^[1a38] and creditors rights to directly assert a cause of action against directors for a breach of fiduciary duty remain unchanged. However, they may assert a derivative claim on behalf of the insolvent incorporation.¹³ Therefore, there is a slight shift in the directors obligations in that they should be considering the interests of creditors when making decisions.

QUESTION 4^[1a39] (fact-based application-type question) [15 marks in total]

Question 4.1^[1a40] [5 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?

Whilst a bankruptcy filing commences an automatic stay¹⁴ of enforcement of actions brought against the debtor and any actions taken to obtain possession of property, the Bankruptcy Code does provide some protection to lessors. Whilst initially, the lessor cannot take any action in accordance with the stay, the Bankruptcy Code allows creditors in certain circumstances to request a lift of the stay,¹⁵ which if granted, allows the creditor to perform actions which would otherwise be prohibited.

There are a few situations in which this relief may be granted, however there are only two which may be applicable to this scenario. Firstly, if the creditor claims that there is inadequate protection of an interest in property, as may be the case of a lessor, and that there is a concern that the realisable value of the property has the potential to decline during the bankruptcy proceedings. In this scenario, the creditor must assess that the value of its claim is more than the value of the secured property. Therefore, an assessment should be carried out as to the value of the property, and the size of their claim, which would normally be determined by contract law or another non-bankruptcy law. Should it be found that the protection is inadequate, the creditor can pursue the debtor for amounts that would be the indubitable equivalent of the value of their claim that is at risk, usually through period cash payments or additional security¹⁶, and the debtor is able to avoid a lifting of the stay. In the eventuality that the remedy does not meet the 'indubitable equivalent' requirement, the creditor will have a priority claim in the bankruptcy for the shortfall as an administrative expense.

¹³ Idem Note 12

¹⁴ 11 U.S. Code § 362 - Automatic stay (a)

¹⁵ Idem 362 (d)

¹⁶ 11 U.S. Code § 361 and 11 U.S. Code § 362 (d)

A second scenario may be applicable whereby the debtor has entered a chapter 7 bankruptcy or chapter 11 reorganisation. In the latter, it must be shown that the debtor has no equity in the property and that 'such property is not necessary to an effective reorganisation'.¹⁷ In a chapter 7 bankruptcy, it must instead only be shown that the debtor has no equity in the property. In the information provided it is confirmed that iWork sub-lets the office space and does not own the properties itself, and therefore this relief may be available to the lessors. Again, the lessor must also evaluate the value of its equity and the value of the property to confirm that the former is greater than the latter.^[1a41]

Lastly, if the lease has expired for any of the properties, the landlord has the right to evict the debtor-tenant, as this is an exception to the automatic stay.

Question 4.2 ^[1a42] [5 marks]

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.

In accordance with chapter 15, to be recognised as a foreign main or non-main proceeding, the foreign representative must show that a foreign proceeding is pending, which may be either via the court or administrative, and that the foreign representative has the power to act in respect of the proceeding.¹⁸ Under the definition provided by the Bankruptcy Code¹⁹, this can include interim proceedings including an English scheme of arrangement, and there is case law demonstrating that English schemes have been recognised in the US Courts, such as for Magyar Telecom B.V.²⁰ whereby the US Courts recognised the scheme and provided that the scheme have full effect in the US. However, there are other circumstances whereby recognition has been refused, such as for Global Cord Blood Corp²¹, because the sole purpose of the proceeding was to conduct an investigation rather than dealing with the

¹⁷ Idem (d)2

¹⁸ 11 U.S. Code § 1501 - Purpose and scope of application

¹⁹ 11 U.S. Code § 101 – “The term "foreign proceeding" means a collective judicial or administrative proceeding in a foreign country, including an interim proceeding, under a law relating to insolvency or adjustment of debt 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.”

²⁰ Magyar Telecom B.V., Re [2013] EWHC 38000 (Ch)

²¹ Global Cord Blood Corp, Case No 22-11347 (DSJ), 2022 WL 17478530 (Bankr SDNY Dec 5, 2022)

company's debts. As the main purpose of a scheme of arrangement is to make an agreement with a company's creditors and shareholders to restructure its debts, Skin Luxe is unlikely to fall into this issue.

To assess whether the proceeding may be recognised as a foreign main or a foreign non-main proceeding, Skin Luxe's centre of main interests (COMI) must be assessed. Chapter 15 is based on the US's adopted of UNCITRAL Model Law, and neither provide a definition of the COMI. It is assumed to be the registered office of the company in the absence of other information, however other factors such as the location of headquarters, primary assets, management, and creditors should all be taken into consideration when determining the COMI.^[1a43] If the proceedings are commenced in a country in which the debtor's COMI is located, the proceedings would be recognised as the foreign main proceedings.^[1a44] If the proceedings are commenced where the entity only has an establishment, this would be recognised as foreign non-main proceedings.^[1a45]

Skin Luxe's principal place of business and place of incorporation is stated as France. Therefore, in the absence of any further information, it can be assumed that this is where the debtor's COMI is located. However, it is also noted that Skin Luxe's bonds are English-governed, and that it holds boutiques across cities in France, US, UK, and Hong Kong, suggesting that the entity's majority creditors could be located in the UK or elsewhere. It is also stated that the company develops and manufactures its products in France, suggesting that this may be the location of its primary assets.

The COMI should be ascertainable by third parties or creditors of Skin Luxe with reference to objective evidence.²² The foreign representative must consider upon commencement of the scheme of arrangement where the COMI is determined to be. As the entity's principal place of business is given as France, and this is where the entity develops and manufactures its products, and in the absence of further information, it is likely that this is where Skin Luxe's COMI would be. There is a case that, because the English scheme of arrangement is being used to restructure English governed bonds, this could also be determined as the COMI.

In the situation whereby France is determined as the COMI, the scheme would be recognised in the US as foreign non-main proceedings.^[1a46] If the court determines that the UK is the Skin Luxe's COMI, then the proceedings would be recognised as foreign main proceedings. The main difference between the recognition of the two is that an automatic stay is enacted upon recognition of foreign main proceedings.²³ There is no automatic stay for non-main proceedings and any relief granted is to the discretion of the court.²⁴

²² Morning Mist Holdings Ltd v Kryss (In re Fairfield Sentry Ltd), 714 F.3d 127

²³ 11 USC Code § 1520

²⁴ 11 USC Code § 1521

Question 4.3 [1a47][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 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?

(i) The DOJ investigation

Upon filing of a voluntary chapter 11 petition by the debtor, an automatic stay is invoked [1a48] which applies to any interference with the debtor's property. However, there are statutory exceptions to the stay which includes regulatory investigations²⁵. Because the potential effects of disallowing the DOJ investigation could cause more harm than good, for example if the debtor is carrying on fraudulent activities and continues to do so, the regulatory investigation will be able to continue [1a49].

(ii) The margin loan default

Another exception to the automatic stay is the exercising of rights under a security contract. The margin loan provided by its broker is likely to be subject to a security contract, given that the shares it purchases are held as collateral. In this situation, the broker will still be able to exercise its rights under this contract and request the shares that are held as collateral due to the default [1a50].

(iii) The delinquent lease

The automatic stay will apply to the lease - initially, the lessor will not be able to take any action against the debtor to collect outstanding payment or to evict the debtor from the property unless the lease has expired. [1a51] If the lease has expired, this would be another exception to the stay of proceedings and the lessor could take action.²⁶ If it is not expired, the lessor can make a claim that its interests lack adequate protection and that the value of the property may decline during the course of the proceedings.²⁷ The lessor would need to assess that the value of the

²⁵ 11 USC Code § 362 b

²⁶ 11 USC Code § 362 b

²⁷ 11 USC Code § 362 d

collateral is less than the secured debt and the court may order that the Speculation Inc makes periodic payments to the lessor to an 'indubitable equivalent' of the lost value.

Alternatively, as Speculation Inc leases the property, and the property may not be necessary for the reorganisation, the lessor may be granted a lifting of the stay and it would be up to Speculation Inc to show a reasonable chance of successful reorganisation within a certain timeframe if it wishes to avoid this.

(iv) Employment discrimination lawsuit

The discrimination lawsuit brought by the employee is likely to be stayed upon petition.^[1a52] It meets the scope of the stay; in that it would be classed as litigation on a pre-petition claim and does not meet the criteria for any exceptions to the stay of proceedings. If the employee were to continue to pursue the lawsuit, they would be in contempt of court and may be subject to contempt sanctions. However, given that the employees claim does not relate to any property of the debtor^[1a53], they may be permitted by the court to proceed with the lawsuit. This would be to the discretion of the court.

** End of Assessment **