

TOTAL = 39.5/50
79%



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 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.
- (d) No, because Parts Inc does not know whether Car Corp is insolvent.**
- (e) No, because Parts Inc is not a US company.

Commented [FV1]: 0, correct answer is C

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.

Commented [FV2]: 0, correct answer is D

- (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.*

Commented [FV3]: 1, correct

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.*

Commented [FV4]: 1, correct

- (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.

Commented [FV5]: 1, correct

(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.

Commented [FV6]: 1, correct

(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.

Commented [FV7]: 1, correct

(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).*

Commented [FV8]: 0, correct answer is E.

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.*

Commented [FV9]: 1, correct

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.

Commented [FV10]: 1, correct

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 when a creditor is allowed to set off the obligation of a debt which is owed to it by the debtor with monies it owes to the debtor. This is allowed pursuant to the strict terms of 11 U.S. Code § 553, failing which the payment from the debtor to the creditor ahead of the proceeding might be considered a preference payment. Strictly, setoff can be described pursuant to 11 U.S. Code § 553 as the "right of a creditor to offset a mutual debt owing by such creditor to the debtor that arose before the commencement of the case under this title against a claim of such creditor against the debtor that arose before the commencement of the case".

Commented [FV11]: 2, correct

*Setoff can considerably improve the position of the creditor compared to other creditors in the same class, because other creditors may only be receiving a *pari passu* amount from available assets, the creditor that benefits from the setoff gets a portion of their claim essentially paid back directly to them in full.*

For example, consider a hypothetical scenario where there are assets in an estate of US\$500 and 5 unsecured creditors with equal claims of US\$500. Creditor X owes US\$100 to the debtor.

Situation A (no setoff)

*If creditor X had paid back (US\$100) due to the debtor, then received a distribution on a *pari passu* basis of US\$120 (500/5 + 100/5) - they will have received US\$20 overall.*

Situation B (setoff)

*But if creditor X had used the setoff method, they would keep the US\$100 and set it off against their claim of US\$500 so they have a remaining claim of US\$400, and receive a *pari passu* distribution of $(400/2400)*500 = US\$83.3$. The total received net they keep in situation B is US\$183.3, which is a considerable improvement of over 9 times compared to what they would receive in situation A.*

This illustrates how setoffs can result in potentially unfair treatment of creditors - and to protect against this unfair treatment there are limitations as to whether setoffs are permissible, as detailed under 11 U.S. Code § 553 (a) (b) (c) and where they are not permissible, setoff will be disallowed.

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?

*A priming lien is a lien which is equal or senior to a pre-petition pre-existing lien on estate property. It is granted by the court pursuant to 11 U.S. Code § 364 (d) in the case of a debtor in possession (DIP) seeking post-petition financing. To secure a priming lien, the debtor needs to demonstrate to the court that the interests of the secured creditor being primed are being protected. The consequence of the priming lien is that in the case of a distribution, the financier will have priority in the waterfall of repayments over other pre-petition secured lenders. This can incentivize an existing creditor with unsecured debt to provide funding to a DIP as they may be able to “roll up” their unsecured debt into secured debt with a **priming** lien, subject to sanction from the court.*

Commented [FV12]: 1.5. Full creditor not given because answer does not mention adequate protection which is defined in the Bankruptcy Code

The court will consider whether other sources of finance have been exhausted/ are unavailable to the DIP in the following order of preference pursuant to 11 U.S. Code § 364 (a - c) before authorizing the sanction of a primary lien:

- i) unsecured debt, or unsecured credit from suppliers; with the debt being granted administrative priority expenses*
- ii) unsecured debt, with the debt being granted priority over administrative expenses;*
- iii) secured debt with a lien on unencumbered estate property; and*
- iv) secured debt with a junior lien on encumbered estate property.*

Question 2.3 [2 marks]

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

A violation of the automatic stay available pursuant to 11 U.S. Code § 362, where the violation does not constitute a statutory exception, would lead to the following consequences:

- **Contempt of Court.** This could result in contempt sanctions, (daily) fines and payments against the party that violated the stay. This could also in sanctions such as the violating party being liable for and paying the debtor's attorney's fees.
- **Voidability of the act.** The violator will need to take affirmative action to undo the act that violated the stay, under penalty that if they do not do so they will be in contempt of court.

Commented [FV13]: 1.5. Full credit not given because answer does not mention that act may be void or voidable depending on the circuit.

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?

Pursuant to 11 USC § 1126(f) and (g), the following classes in a plan of reorganization are deemed to (i) deemed to accept the plan, (ii) deemed to reject the plan and (iii) permitted to vote on the plan:

- Unimpaired classes - this is a class whose legal, contractual and equitable rights have been left un-altered. Even if the class is paid in full before the plan is proposed, they might be considered impaired, due to the time-value of money and the fact they could have received this sooner. However, compensating the holder in this class for damages could repair them to an unimpaired state.*
- Classes who receive nothing are deemed to automatically reject the plan. Note that no class should receive less then they would in a chapter 7 proceeding, unless they consent.*
- "Impaired classes" are permitted to vote on the plan.*

Commented [FV14]: 2, correct

Pursuant to 11 USC, §§ 1126(c) and (d), the plan is approved by an impaired class of creditors if over 50% of the creditors within that class vote for the plan and those creditor(s) hold at least 2/3rds of the value of claims. The plan is approved by equity shareholders if over 2/3rd of the shareholders with equity interest vote for the plan.

Question 2.5 [3 marks]

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

- Which cause of action applies only to transfers made on account of antecedent debt?**
- 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?**

a) **Preference payment.**

Preference payments pursuant to 11 USC, § 547 may only arise if there existed a pre-appointment pre-existing debt at the point the debtor transferred funds to the creditor.

b) **Actual fraudulent conveyance or constructive fraudulent conveyance**

In neither the case of actual fraudulent conveyance or constructive fraudulent conveyance is it absolutely necessary to prove that the debtor is insolvent at the time of transfer - however it could be considered as one of the many "badges of fraud" as seen in *Ritchie Capital Mgmt, LLC v Stoebner*, 779 F.3d 857 (8th Cir 2015). Once intent is established, the test for whether actual fraudulent conveyance took place pursuant to 11 U.S. Code § 548 is whether a transfer in the 2-year look back period "incurred such obligation with actual intent to hinder, delay, or defraud any entity to which the debtor was or became, on or after the date that such transfer was made or such obligation was incurred, indebted".

Additionally, it could be considered one of the additional factors necessary to demonstrate constructive fraudulent conveyance pursuant to 11 U.S. Code § 548 (a), if in addition to this it could be demonstrated that the debtor received less than a reasonably equivalent value in exchange for such transfer or obligation. This would have needed to occur in the two-year pre-petition look-back period.

c) **"Constructive fraudulent conveyances", and "Actual fraudulent conveyances".**

- In a constructive fraudulent conveyance, it is necessary to show that the debtor would have received less than reasonably equivalent consideration in exchange for a transfer that took place within the two year look back period, which is equivalent to "frustrating creditors' recoveries".
- In an actual fraudulent conveyance, it is necessary to show that the debtor "incurred such obligation with actual intent to hinder, delay, or defraud any entity to which the debtor was or became, on or after the date that such transfer was made or such obligation was incurred, indebted". Here the word hinder and frustrate could be considered interchangeable.

Note that with preference payments, it is not necessary to show fault of the debtor in frustrating creditor's recoveries.

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

Question 3.1 [3 marks]

Commented [FV15]: 1. The answer for b is preference. The answer for c is actual fraudulent transfer

Commented [la16]: 14.5/15 marks

Commented [la17]: 2.5/3 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.

Bankruptcy courts are not created directly by Article III of the US constitution, bankruptcy judges are not appointed directly by the president of the United States. Instead, they are appointed by courts of appeal, which were created by legislation (1978 Bankruptcy Code) and therefore have limited jurisdiction to enter into final orders on "non-core" issues - which are issues related to Article III of the US constitution.

Therefore, at the outset of proceedings and pursuant to 28 U.S. Code § 157, parties must decide whether the issues at hand are core issues or non-core issues. The final say will be had by the bankruptcy judge as to whether an issue is core or non-core. The bankruptcy court may only enter into a final order consistent with the US constitution if they are ruling on core matters, and the order disposes of the entire issue heard at the hearing (as opposed to an interlocutory order, that only deals with some of the issues).

Appeals from bankruptcy courts are heard by the district court in the same district in which the bankruptcy court sits or in some cases, a Bankruptcy Appellate Panel (BAP). In very rare cases, they might go directly to the court of appeal where it concerns an area of law untested by the circuit or Supreme Court.

Pursuant to 28 U.S. Code § 157, Orders (c) that are not constitutionally final can be entered into by the bankruptcy court if they relate to a non-core issue with sufficient relevance to a bankruptcy proceeding, following which both i) the findings of fact and ii) conclusions of law of the bankruptcy court will be reviewed by the district court on a de novo basis, who will have the power to produce a final order or judgement.

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?

The wording of Chapter 15 provided by the Bankruptcy Code does not include that the foreign representative may invoke the avoidance provisions/ powers relating to preferences and fraudulent conveyances in the ancillary US bankruptcy. These may only be invoked in US plenary proceedings, such as i) chapter 7 or ii) chapter 11.

Additionally, pursuant to § 1521(a)(7) - foreign representative is excluded from the discretionary relief that may be granted upon recognition under sections 522, 544, 545, 547, 548, 550, and 724(a).

Commented [la18]: Partially correct, 1/2 mark, the bankruptcy court can enter a final order on a core proceeding only if exclusive to the Bankruptcy Code (such as a challenge to a petition) or the parties consent.

Commented [la19]: This is finality for purposes of appeal which is separate from the question of constitutional finality.

Commented [la20]: Correct, 1/2 mark

Commented [la21]: Correct, 1/2 mark

Commented [la22]: Correct, 1 mark

Commented [la23]: 3/3 marks

Commented [la24]: Correct, 1 mark

However, as seen re *Condor Ins Ltd, 601 F.3d 319, 329 (5th Cir 2010)*, the above does not prevent a foreign representative to seek to avoid pre-petition transactions under other applicable foreign or US law.

Commented [la25]: Correct, 1 mark

The foreign representative may choose to begin chapter 7 or chapter 11 plenary proceeding under the bankruptcy code after securing Chapter 15 recognition. In this specific case, the scope of the plenary proceedings will be limited to the debtor's US assets - however the representative will be able to take advantage of avoidance provisions/ powers granted under the Bankruptcy Code. The foreign and domestic proceedings will then run concurrently which will require some coordination.

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Question 3.3 [4 marks]

Commented [la27]: 4/4 marks

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

One should go to the following website to download the applicable bankruptcy forms: <http://www.uscourts.gov/forms/bankruptcy-forms>

The practitioner should also acquaint themselves with the local rules and chambers procedures of the bankruptcy court in question, as well as the personal preferences, procedures, and practices of the sitting judge. These will be publicly available on the bankruptcy court website in question. It is important to check these as judges may modify and have bespoke deadlines for filings and pleadings.

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Commented [la29]: Correct, 1 mark

The practitioner should also review the Bankruptcy Rules, and the Federal Rules of Civil Procedure. If the practitioner does not practice regularly in the jurisdiction in which they are making a filing, they should consult with a local practitioner to ensure that filings are made adequately and within local guidelines.

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Commented [la31]: Correct, 1 mark

Question 3.4 [5 marks]

Commented [la32]: 5/5 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?

The fiduciary duty owed by the Delaware directors is to the debtor and its shareholders. There are two fiduciary duties owed to them, the first being i) a fiduciary duty of care and ii) a fiduciary duty of loyalty. It should be noted that the directors may be excused from owing a fiduciary duty of care by the debtor's certificate of incorporation. However, the Delaware directors will always owe a fiduciary duty of loyalty to the debtor and its shareholders.

Commented [la33]: Correct, 1 mark

Commented [la34]: Correct, 1 mark

Commented [la35]: Correct, 1 mark

Commented [la36]: Correct, 1 mark

The Delaware directors don't owe a duty to the creditors of the Company in the ordinary course of business, whether or not the Company is insolvent - as the concept of "wrongful trading" does not apply in the US. Any debate on the issue has been clarified following the Delaware Supreme Court decision of *North Am Catholic Educational Programming Foundation, Inc v Gheewalla, 930 A.2d 92, 103 (Del 2007)* where it was decided that "Individual creditors of an insolvent corporation have no

Commented [la37]: Correct, 1 mark

right to assert direct claims for breach of fiduciary duty against corporate directors. Creditors may nonetheless protect their interest by bringing derivative claims on behalf of the insolvent corporation.”

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

Commented [la38]: 10/15 marks

Question 4.1 [5 marks]

Commented [la39]: 2/5 mark

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?

There has been a breach of contract, the building owners have granted a lease to iWork Ltd, and iWork Ltd have failed to pay rent. This has created a debt, which remains to be paid. As such, depending on the quantum of their claim and the number of office building owners who are owed outstanding rent - the office building owners can petition to place iWork Ltd into Chapter 7 or Chapter 11 proceedings. Once iWork Ltd is in bankruptcy proceedings, the business operators can submit a claim in the proceedings for pre-petition unpaid debts.

Commented [la40]: Correct, 1 mark

*In chapter 7 proceedings, the bankruptcy trustee can take steps to collect and realise the debtor's assets and distribute the proceeds to the creditors of the debtor, including the lessors of office space, on a *pari passu* basis. It is likely that the lessors of office space are unsecured creditors and will therefore receive distributions after employees and secured creditors.*

In chapter 11 proceedings, a plan of reorganization may be implemented, and the lessors of office space will likely qualify as an impaired class of creditors - given them the ability to vote on the reorganization plan which will restructure their debt. The lessors of office space can form a creditor or statutory committee with other creditors and cause the debtor to pay the fees of that committee's lawyers and advisors.

*It should be noted that *ipso facto* clauses are nullified under the Bankruptcy Code therefore iWork Ltd entering into bankruptcy proceedings would be insufficient for it to have to stop paying rent. However, the contract would be an executory one, as there remain unperformed obligations (i.e. the non-payment of rent). In both chapter 7 and chapter 11 proceedings - the debtor could elect within 60 to 120 days respectively from the order of relief, to i) reject the contract ii) assume the contract or iii) assume and assign the contract. In the cases of ii) and iii), the debtor would have to compensate the office building owners by paying them the outstanding rent + damages. In the case of i), the office building owners would have a claim for outstanding rent up to the date of the petition being made.*

Commented [la41]: Correct, 1 mark. The debtor can seek up to 90 additional days for cause, but no longer without landlord consent. The debtor also must pay post-petition rent as an administrative expense. If the debtor assumes and then rejects the lease, the landlord is entitled to 2 years' rent as an administrative expense.

Question 4.2 [5 marks]

Commented [la42]: 5/5 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.

Non-main Proceedings

Because the place of incorporation of Skin Luxe is in France, and this is where it develops and manufactures high end skincare products - this will likely be considered the COMI of Skin Luxe. If proceedings were to happen in France and a French representative were to look for recognition under chapter 15, then these would likely be considered main proceedings.

Commented [la43]: Correct, 1 mark

Commented [la44]: Correct, 1 mark

It should be noted that pursuant to 11 USC, § 1516(c), the place of incorporation being France might be sufficient to establish COMI there - on a rebuttable basis. Pursuant to Morning Mist, 714 F.3d at 134, "A debtor's COMI should be ascertainable by its creditors or other third parties on the basis of objective evidence" - this is likely to be France as that is where the principal place of business is located. In addition, the location of headquarters, management and primary assets of the debtor all form part of the factors that influence the location of the debtor's COMI, and the fact that the R&D takes place in France too further strengthens the understanding that COMI is located in France. In the US, COMI is considered at the date of the Chapter 15 petition (as opposed to the start of the foreign proceedings).

Commented [la45]: Correct, 1 mark

The English Scheme of arrangement would only be recognized as a foreign non-main proceeding if it can be established that the debtor has an establishment in the UK, at the date of the chapter 15 petition. To establish this, it is necessary to demonstrate that Skin Luxe carries out transitory economic activity there, which it should be able to as it sells skin products in boutiques in London. Therefore, the English scheme of arrangement would be recognized as non-main proceedings.

Commented [la46]: Correct, 1 mark

Commented [la47]: Correct, 1 mark

Foreign Proceedings begun by a Foreign Representative

A foreign proceeding does not necessarily need to resemble a US proceeding to be recognized under Chapter 15. Pursuant to USC § 101(23), the foreign proceeding needs to be for the purposes of liquidation or reorganization, under a law relating to insolvency or adjustment of debt, and collective in nature, to be recognized. The English scheme of arrangement would be considered to meet the above requirements as it would be a collective scheme for the purposes of reorganization and would be under a law relating to adjustment of debt. The English provisional liquidator or

trustee would also likely meet the criteria of “foreign representative”, which is necessary for recognition under chapter 15.

US presence

Skin Luxe will be considered to have sufficient of a presence in the US to begin Chapter 15 proceedings there. The *de minis* test for a debtor to be under any chapter of the US Bankruptcy code pursuant to 11 USC, § 109, is for the debtor to be located in the US, have assets in the US or a place of business. Here, we are told that Skin Luxe owns property (boutiques) in Las Vegas, which would qualify both as a place of business and as assets.

Upon recognition, the venue where the Chapter 15 recognition and ancillary proceedings would take place is likely to be Las Vegas because this is the venue in which the debtor has its principal place of business/assets in the US.

Question 4.3 [5 marks]

Commented [la48]: 3/5 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 US department of Justice (DOJ) investigation would be allowed to continue as it relates to illegal insider trading - which is a criminal offence and therefore exempt from the automatic stay pursuant to 11 USC, § 362(b)(1): “under subsection (a) of this section, of the commencement or continuation of a criminal action or proceeding against the debtor”. It is therefore expected that the Chapter 11 trustee (or debtor in possession) and the DOJ would collaborate through the investigation on matters such as books and records and examination of personnel.**
- ii) **We are told that the shares purchased as held as collateral against the margin loan. If Speculation Inc has had serious trading and defaulted on the margin loans, then the broker would be a secured creditor for the shares held as collateral - albeit, it is likely that the value of these has also plummeted. While the automatic stay would prevent the broker from enforcement against Speculation Inc, the automatic stay could also be lifted**

Commented [la49]: Correct, 1 mark

Commented [la50]: Incorrect, the margin loan is a securities contract that is exempt from the automatic stay, so the broker can sell the shares notwithstanding the bankruptcy filing

pursuant to 11 USC, § 362(d) at the request of the broker pursuant to “lack of protection” due to the plummeting value of the shares leading to the likelihood of a decent recovery decreasing the longer the Chapter 11 proceedings go on for. To circumvent the automatic stay being lifted, Speculation Inc could provide the “indubitable equivalent” of the value of the shares through periodic cash payments (for example).

It should be noted that pursuant to USC § 546(e)-(g) and (j) - the payment of the margin loan cannot be voided as a preference or fraudulent conveyance - unless done with the intent to defraud creditors.

- iii) **The delinquency on the lease will result in an unsecured claim for outstanding rent against Speculation In.** It should be noted that *ipso facto* clauses are nullified under the Bankruptcy Code therefore Speculation Inc entering into bankruptcy proceedings would be insufficient for it to have to stop paying rent. However, the contract would be an executory one, as there remain unperformed obligations (i.e. the non-payment of rent). Following the proceedings commencing - the debtor could elect to i) reject the contract ii) assume the contract or iii) assume and assign the contract. In the cases of ii) and iii), the debtor would have to compensate the office building owners by paying them the outstanding rent + damages. In the case of i), the office building owners would have a claim for outstanding rent up to the date of the petition being made.
- iv) **The employment discrimination lawsuit will be stayed,** as it does not constitute as one of the civil action proceedings pursuant to 11 USC, § 362(b)(2)(a). Pursuant to 11 USC, § 362 (a), a stay on “the commencement or continuation, including the issuance or employment of process, of a judicial, administrative, or other action or proceeding against the debtor that was or could have been commenced before the commencement of the case under this title, or to recover a claim against the debtor that arose before the commencement of the case under this title;” operates as soon as a petition for chapter 11 is filed.

Commented [la51]: Specifically, the automatic stay will protect the debtor from any action to evict for failure to pay rent, and the automatic stay will come into effect on the filing of the petition.

Commented [la52]: Correct, 1 mark

* End of Assessment *