

TOTAL = 41/50
82%



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.

(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.

Commented [FV1]: 0, correct answer is C

Commented [FV2]: 1, correct

(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?

Commented [FV3]: 1, correct

Commented [FV4]: 1, correct

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

Commented [FV5]: 1, correct

(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.

Commented [FV6]: 1, correct

(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.

Commented [FV7]: 1, correct

(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). page 32

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.*

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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?

A setoff allows a creditor with a claim against a debtor, who also owes money to the debtor, to net out the two (or more) obligations (i.e. set the two or more amounts off against each other).¹

Setoff is not permitted in many circumstances because it can put a particular creditor in a better position compared to other unsecured creditor who are not owed money by the debtor. In essence, "it decreases its obligation to the estate by the full amount owed by the debtor rather than the lesser amount the debtor would pay on the unsecured claim."²

Commented [FV11]: 1, correct

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 form of security that may be granted by the court to secure post-petition financing. It may be senior or equal to a pre-petition lien on estate property and will have priority in collateral over the pre-petition secured lenders.³

¹ Module 3A Guidance Text Insolvency System of the United States (Guidance Text), Section 5.7.4.

² Ibid.

³ Guidance Text, Sections 5.4.4 and 5.6.1.

A priming lien will only be granted if post-petition financing cannot be obtained on any other terms and if the debtor can demonstrate that the interest of the secured creditor being primed is adequately protected.

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Question 2.3 [2 marks]

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

The key potential consequence of a violation of the automatic stay is that the violator will be in contempt of Court. However, contempt may be void or voidable and parties in interest may apply to lift the stay prospectively or retroactively. If a party in interest fails to seek such relief, then the court may impose contempt sanctions such as (i) payment of the debtors' attorneys' fees; (ii) requiring the violator to take action to reverse the effect of its violation; or (iii) even coercive sanctions such as a daily fine to be paid to the court until the stay violation has been rectified.⁴

Commented [FV13]: 1.5. Full credit not given because the act (not contempt) may be void or voidable depending on the circuit.

As per a recent ruling of the US Supreme Court, there will be no consequences if the action doesn't impact the status quo of the estate's property.⁵

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?

An unimpaired class of creditors will be deemed to accept the plan of reorganization.⁶ A class of creditors will only be considered unimpaired if the plan of reorganization leaves the creditor's "legal, equitable, and contractual rights unaltered"⁷ or if the "plan reverses contractual acceleration by curing any monetary default and compensating the holder for any damages".⁸

A class of creditors who will receive nothing following the plan of reorganization will be deemed to reject the plan.⁹

The necessary vote for a class of creditors to accept a plan of reorganization is a simple majority of the creditors in the class, holding at least two-thirds of the value of claims in the class; or in the case of equity interests, two-thirds in amount of those interest vote in favour.¹⁰

Commented [FV14]: 2, correct

Question 2.5 [3 marks]

⁴ Guidance Text, Section 5.4.2.2.

⁵ *City of Chicago v Fulton*, 529 US 140 (2021).

⁶ Guidance Text, Section 5.5.4.1.

⁷ Guidance Text, Section 5.5.3.1.

⁸ *Ibid* and the United States Code (USC) § 1124.

⁹ Guidance Text, Section 5.5.4.1 USC §§ 1126(f) and (g).

¹⁰ Guidance Text, Section 5.5.4.1 and 11 USC, §§ 1126(c) and (d).

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?**

With respect to (a), the cause of action which applies only to transfers made on account of antecedent debt is a preference claim. "A preference is a transfer of the debtor's property made in a suspect period before the petition date that must be returned to the estate if it exceeds the amount the recipient would have received in a chapter 7 liquidation had the transfer not been made."¹¹ The suspect period is the 90-day period prior to the petition date. In order to make out a preference claim, it is necessary to prove that the relevant transfer occurred in that 90-day period and that it was made for or on account of an antecedent debt that was owed by the debtor before that transfer was made. This is because preferences only arise where the debtor is paying a creditor for an existing debt.¹²

Similarly, with respect to (b) a preference claim also requires proof that the debtor was insolvent at the time of making the transfer. Pursuant to 11 USC, § 547(f), a debtor is presumed to have been insolvent on and during the 90 days prior to the petition date. Any creditor may present evidence to rebut the presumption but the burden of proving insolvency on a balance sheet basis at the time of the transfer is on the trustee or debtor.¹³

With respect to (c), actual fraudulent conveyances require the debtor to be proven to have made a transfer or incurred an obligation "with actual intent to hinder, delay, or defraud any entity to which the debtor was or became . . . indebted."¹⁴ Intending to hinder, delay or defraud any entity to which the debtor was or became indebted represents frustrating creditors' recoveries. Such an intention is not required to establish that there has been a constructive fraudulent conveyance.¹⁵

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

Question 3.1 [3 marks]

¹¹ Guidance Text, Section 5.7.2.1 and 11 USC, § 547.

¹² Guidance Text, 5.7.2.1, page 52.

¹³ USC § 101(32).

¹⁴ *Ritchie Capital Mgmt, LLC v Stoebner*, 779 F.3d 857 (8th Cir 2015) and USC § 548(a).

¹⁵ Guidance Text, page 58.

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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.

The US bankruptcy court was created by statute, specifically the 1978 Bankruptcy Code, rather than directly by Article III of the US Constitution which established most other US federal courts.¹⁶ A result of this is that the bankruptcy courts have limited jurisdiction to enter final orders other than on **core bankruptcy issues**.¹⁷

Section 157 of the Bankruptcy Code sets out a non-exhaustive list of core proceedings, which include for example, matters concerning the administration of estates, preference claims and determinations as to the discharge of debts, among many other things.¹⁸

If the matter in issue is a non-core matter, the bankruptcy court may only hear the matter if it is sufficiently connected to a bankruptcy proceeding and cannot make a final determination and instead **must submit its determination to the district court at which any interested parties may participate and object before the district court makes the final decision on the matter**.

Due to various jurisdictional challenges over the years, and conflicts between the kinds of orders that the bankruptcy courts can make as opposed to the Article III Courts, the Bankruptcy Code has been amended from time to time to clarify the bankruptcy court's jurisdiction and powers. One case which caused controversy was, *Stern v Marshall*/564 US 462 (2011), which held that the bankruptcy court's issuance of a final order in respect of a counterclaim over a state law claim was unconstitutional under Article III. This decision was made, notwithstanding that 28 USC § 157 provides that a counterclaim is a core proceeding as to which a bankruptcy court can issue a final order.

Similar to the circumstances that apply to a bankruptcy court's determination of a non-core proceeding, the US Supreme Court has held that the bankruptcy court may determine a core proceeding over which they lack constitutional authority by issuing a report and recommendation for review by the district.¹⁹ The Bankruptcy Rules have codified this decision to some extent by requiring parties to specify in their pleadings whether they consent to the entry of final orders or judgment by the bankruptcy court and by allowing a district court that determines that a bankruptcy court did not have jurisdiction to enter a final order to treat that its order as proposed findings of fact and conclusions of law.²⁰ This essentially provides a process for how orders that are not constitutionally final are reviewed and approved.

¹⁶ Guidance Text, 5.3.4.4.

¹⁷ Guidance Text, Section 5.1.

¹⁸ Bankruptcy Code, section 157.

¹⁹ *Executive Benefits Ins Agency v Arkinson*, 134 S. Ct. 2165 (2014)

²⁰ Fed R Bankr P 8018.1

Commented [la18]: Specifically, the bankruptcy court can enter a final order on a core proceeding that is exclusive to the Bankruptcy Code (e.g., a challenge to a petition) or where the parties consent

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With respect to appeals from bankruptcy court orders, those matters are typically heard and determined by the district court for the district of the relevant bankruptcy court.²¹ However, the First, Sixth, Eighth, Ninth and Tenth Circuits have elected, pursuant to 28 USC, § 158(b), to form Bankruptcy Appellate Panels (BAP), of the judges of the bankruptcy court in those circuits, which hear appeals from the bankruptcy courts in those circuits. Parties in those circuits still have the right to request that the appeal be heard by the relevant district court instead.

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Following an appeal decision by a BAP or district court, there is a further right of appeal to the circuit court of appeals.²² Sometimes a case will go directly from the first instance court to the court of appeals, but only if "(i) the appeal raises a question of law as to which there is no controlling decision of the circuit or the US Supreme Court, or requires resolving conflicting controlling decisions, or (ii) immediate appeal may materially advance the progress of the case."²³ and the appeal court accepts that the case meets those criteria.

Question 3.2 [3 marks]

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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?

Chapter 15 of the Bankruptcy Code closely follows the UNCITRAL Model Law on Cross Border Insolvency (the MLCBI), however, it does specifically exclude from the rights that are granted to foreign representatives, the use of avoidance powers that are provided for in the Bankruptcy Code.²⁴

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§ 1521(a)(7) has generally been interpreted to only restrict the use of the Bankruptcy Code's powers of avoidance of preferences and fraudulent conveyances and not to prevent a foreign representative from seeking to avoid pre-petition transactions under other applicable US or foreign laws.²⁵ This interpretation aligns with cases that were brought under section 304 of the Bankruptcy Code which governed the recognition and enforcement of foreign insolvency proceedings prior to the enactment of Chapter 15.²⁶

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A foreign representative is able to invoke the Bankruptcy Code's avoidance powers in plenary proceedings pursuant to chapter 7 or 11,²⁷ however, that can only be done after recognition of the foreign proceedings under chapter 15.²⁸ Chapter 7 are in essence typical insolvency proceedings which involve appointing a trustee to take

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²¹ Guidance Text, Section 5.3.5.3.

²² Ibid.

²³ Ibid and 28 USC, § 158(d).

²⁴ § 1521(a)(7)

²⁵ *In re Condor Ins Ltd*, 601 F.3d 319, 329 (5th Cir 2010).

²⁶ Guidance Text, Sections 6.2.4 and 6.1.

²⁷ 11 USC, § 1523(a).

²⁸ § 1511

control of the debtor's estate, collect and liquidate property including prosecuting claims the estate possesses against others, and distributing the proceeds to creditors in accordance with statutory priorities.²⁹ Chapter 11 proceedings are essentially a US form of restructuring with a set process for the plan and reorganization of a debtor's business.

If a foreign representative commences chapter 7 or 11 plenary proceedings after recognition of the foreign proceedings under chapter 15, the scope of those plenary proceeding would be limited to the debtor's US assets and will be coordinated with the foreign proceeding.³⁰ Foreign representatives may choose to commence plenary proceedings if it is apparent that the foreign laws do not allow for certain claims, such as claims for constructive fraudulent conveyances, or if there are statute of limitations issues which would preclude a necessary claim.³¹

Question 3.3 [4 marks]

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

When preparing a filing for a bankruptcy court, there are a number of relevant rules that one should review.

First, the **Federal Rules of Bankruptcy Procedure** (the Bankruptcy Rules) are critical because they are the primary rules governing bankruptcy proceedings.³² As set out above in question 3.1, these rules have been amended various times in order to guide practitioners following confusion with respect to jurisdictional issues. The Bankruptcy Rules obviously deal with all aspects of bankruptcy proceedings in the United States.

Second, and relatedly, the **Federal Rules of Civil Procedure** are relevant particularly in relation to litigious matters and are frequently incorporated in the Bankruptcy Rules.³³

Third, it is important to have regard to the **local rules of procedure in the district of the bankruptcy court**. For example, the local rules of the Bankruptcy Court for the District of Delaware are available at <http://www.deb.uscourts.gov/local-rules-and-orders>.

Fourth, regard should be had to the **relevant judge's personal practices**. This may be drawn from personal experience, or it may be drawn from Court sources such as the relevant district court's website.

The local rules and the judges' personal practices can be critical in terms of procedure but can also specify unique deadlines and timeframes for filings etc. Seeking advice

²⁹ 5.2

³⁰ § 1528

³¹ 6.2.4

³² 4.1, page 5.

³³ Ibid.

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Commented [la30]: Correct, 1 mark

from a local practitioner on any unwritten rules of preferred practices is recommended for practitioners who do not practice regularly in a jurisdiction.³⁴

Question 3.4 [5 marks]

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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?

Although directors' duties are a matter for state law, it is useful to focus on the duties of directors of corporations in Delaware considering that it is the pre-eminent US jurisdiction for corporate law. In addition, many other US states have modeled their corporate laws on Delaware's legislation.³⁵

In the ordinary course of business, directors of Delaware corporations owe:

1. a fiduciary "duty of loyalty" to the corporation's best interest; and
2. a "duty of care" in educated decision-making, but are protected from liability for errors of judgment by the business judgment rule.³⁶

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Commented [la33]: Correct, 1 mark

In accordance with the business judgment rule, a board of directors will be presumed to have acted in good faith if they acted on the basis reasonable information. On the contrary, if it can be shown that they acted without reasonable information or were not reasonably informed, did not act in good faith or did not truly believe that their decision was in the best interests of the company, then the presumption can be rebutted. Directors will not be liable unless the presumption is rebutted, or they are found to have been grossly negligent in their actions.³⁷

The above-mentioned directors duties are owed to the corporation and its shareholders. Directors do not owe these duties to creditors of the corporation, even if the corporation is potentially insolvent.³⁸

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Commented [la35]: Correct, 1 mark

Commented [la36]: Correct, 1 mark

*Similarly, the Delaware Supreme Court in the case of *North Am Catholic Educational Programming Foundation, Inc v Gheewalla*, 930 A.2d 92, 103 (Del 2007) has confirmed that directors do not owe duties to creditors when a company is operating "in the zone of insolvency", or actually insolvent. The Court said that "[I]ndividual creditors of an insolvent corporation have no 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"³⁹*

³⁴ Ibid.

³⁵ Guidance Text, footnote 182.

³⁶ Guidance Text, Section 5.7.5.

³⁷ Ibid.

³⁸ Ibid.

³⁹ *North Am Catholic Educational Programming Foundation, Inc v Gheewalla*, 930 A.2d 92, 103 (Del 2007).

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

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Question 4.1 [5 marks]

Commented [la38]: 2/5 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?

In view of the fact that iWork Ltd (iWork) has failed to pay rent on some of its office space leases the first consideration is whether these leases are unexpired leases are executory contracts for the purpose of the Bankruptcy Code. On the basis that these leases are ongoing and unexpired it is likely that they are executory on the basis that there are material unperformed obligations on both sides.⁴⁰ In particular, iWork owes rent, and the lessors are obligated to provide the premises until the end of the term, under certain conditions, payment of rent usually being a critical one.

Commented [la39]: Specifically, the lenders have an unsecured claim for unpaid pre-petition rent, but are entitled to post-petition rent as an administrative expense. If the debtor assumes and then rejects the lease, it owes 2 years' rent as an administrative expense.

Another aspect to consider is the nature of the property, in this case we are told that they are office buildings, so it would be safe to assume that they are non-residential properties.

Although we haven't been told whether there are proceedings on foot or what iWork's plan is, for example, does it wish file chapter 11 proceedings to reorganize. Both chapter 11 and chapter 7 provide the trustee (chapter 7) or the debtor in this case iWork (chapter 11) with the ability to make decisions about the assumption and assignment or rejection of executory contracts.

In a Chapter 7 proceeding, the trustee would have 60 days from the date of the petition to decide whether to assign, assume or reject the leases, whereas iWork would have 120 days in a Chapter 11 reorganisation scenario. The 120 limit flows from 11 USC, § 365(d)(4) and the above assessment that the property is non-residential. The period can be extended for cause; however, any subsequent extension would require the consent of the lessor. Both this time limit and extension provision gives the lessors, more protection and power with respect to the process and means that the process can't draw on for too long. In a chapter 7 scenario, where the outcome is liquidation, it seems more likely that the leases would be rejected offering less protection to the lessors.

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The worldwide automatic stay would come into effect immediately on the filing of any plenary petition under chapter 7 or 11, however, it may be lifted on creditor request. The lessors could make such an application under s 362(d) to permit otherwise prohibited action by them.

Question 4.2 [5 marks]

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⁴⁰ Guidance Text, 5.4.5.

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.

If Skin Luxe (SL) commences an English scheme of arrangement to restructure its bonds, the foreign representative may commence a proceeding under chapter 15 by filing a petition. In order to obtain recognition, all that the foreign representative needs to be able to establish is that a foreign court or administrative proceeding with respect to SL is pending in England and that the foreign representative is empowered to act by the proceeding.⁴¹

Pursuant to the Bankruptcy Code, a foreign proceeding is defined as "a collective judicial or administrative proceeding in a foreign country . . . 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."⁴² This definition is broad and have been deemed to cover proceedings such as English schemes of arrangement.

As such, it doesn't seem controversial that an English scheme of arrangement, if commenced, would be capable of being recognized in the US, however, the question of whether the scheme would be considered a foreign main or foreign non-main proceeding is more complex and important as it would determine the scope of relief available following recognition.

Foreign main proceedings are those that are commenced in the debtor's center of main interest (COMI). A debtor's COMI is presumed to be its place of incorporation but that may be rebutted.⁴³ With respect to SL, we are told that it is incorporated in France which gives us a starting position that France will be SL's COMI unless that can be rebutted due to other factors.

Commented [la43]: Correct, 1 mark

Commented [la44]: Correct, 1 mark

Other factors that are relevant to determine COMI include, the:

- 1. location of headquarters;***
- 2. location of management;***

⁴¹ Guidance Text, 6.2.2.

⁴² USC § 101(23).

⁴³ *Morning Mist Holdings Ltd v Kryz (In re Fairfield Sentry Ltd)*, 714 F.3d 127, 133-34 (2d Cir 2013) (determining COMI as of filing of ch 15)).

3. location of primary assets;

4. 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

5. jurisdiction whose law will apply to most disputes.⁴⁴

Taking each of these matters in turn, although we aren't told specifically, it appears that SL's headquarters may also be in France on the basis that SL has a principal place of business there and that is where it develops and manufactures high end skincare products. Similarly, we don't have enough facts in relation to the location of SL's management. With regards to SL's assets, we know that SL has a manufacturing facility in France and also a boutique. It also has boutiques in other major cities including London in England. However, we do not know the location of the English law governed bonds, it may be that they are also in England and that would be a sensible assumption given that they are governed by English law, but we would need to find out. In relation to the location of a majority of SL's creditors, again we need more information, but it is possibly also England on the basis that the bonds are English law governed, however, it could also be equally be France in view of the operations there. Finally, based on the facts we know that English law governs the bonds but that is it.

In view of the above, it is arguable that SL's COMI could be in France (due to its incorporation and principal manufacturing) but there are also good arguments that SL's COMI is in England by reason of its boutique there, the bonds, potential location of creditors pursuant to the bonds and the fact that English law applies to the bonds at least. In view of this, it is arguable that an English Scheme would be a foreign main proceeding for which the foreign representative could seek recognition of in the US.

It would still be possible to seek recognition under chapter 15 of the Scheme proceedings in England on the basis that they are foreign non-main proceedings if it can be shown that SL has an establishment in England. An establishment constitutes a place where the debtor carries out non-transitory economic activity - prior to the commencement of chapter 15 proceedings.⁴⁵

On the basis that SL has a boutique in London, it seems that SL is trading in England and carrying out non-transitory economic activity that has been ongoing before the commencement of the chapter 15 proceedings. In view of this, the foreign representative could apply for recognition of the English scheme as foreign non main proceedings in the alternative.

Further information is required to make a firm assessment regarding which option would be best.

Question 4.3 [5 marks]

⁴⁴ *In re SPhinX, Ltd*, 351 BR 103, 117 (Bankr SDNY 2006).

⁴⁵ 11 USC, § 1502(2).

Commented [la45]: Partially correct, 1/2 mark, on these facts it is highly likely the presumption that the COMI is in France will not be rebutted

Commented [la46]: Correct, 1 mark

Commented [la47]: Correct, 1 mark

Commented [la48]: 2/5

Speculation Inc is engaged in day-trading stocks from leased office space with two employees. It funds its trading through a margin loan from its broker, where the shares it purchases are held as collateral. For a while, Speculation Inc was very successful in trading, and the US Department of Justice (DOJ) has announced an investigation into whether its success was due to illegally trading on insider information. More recently, Speculation Inc has had serious trading losses, causing its broker to declare a default on the margin loan. It also has fallen behind on its rent, and 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: **A worldwide automatic stay of any proceeding against the debtor or its property immediately on the filing of a Chapter 11 restructuring proceeding. The stay is extremely broad and its purpose is to allow the debtor, in this case Speculation Inc (Speculation) breathing space to continue operating whilst it proposes a plan of reorganisation to restructure its debt. However, unfortunately for Speculation, the automatic stay would have impact on the DOJ investigation because the automatic stay is subject to certain statutory exceptions, regulatory investigations being one of them. As a result, the Chapter 11 proceedings would have no effect on the DOJ investigation, and it would be allowed to continue.**
- (ii) Margin loan default: **The automatic stay will prevent the broker from being able to commence any proceedings against Speculation in respect of the margin loan default. This will give Speculation time to work with the broker (and other creditors) and decide how it wishes to adjust its debt. Depending on the other creditors and what's in the plan, it might be necessary to consider whether a cramdown of any dissenting impaired classes of creditors is a tool that could be used in Spectrum's favour. Any cramdown plan must be proposed in good faith.⁴⁶**
- (iii) The delinquent lease: **Pursuant to § 1121 of the Bankruptcy Code, Spectrum would have 120 days from the date of the petition in which to propose its plan of reorganisation. Pursuant to 11 USC, § 365(d)(4), it will also have 120 days to make any decisions with respect to unexpired leases including the assumption, assignment or rejection of the delinquent unexpired lease of the property. This period can be extended for cause. Spectrum's decision will likely depend on the rest of its plan for reorganisation. Pursuant to 11 USC, § 521, Spectrum is also required to file a schedule of information in relation to various matters including executory contracts and unexpired leases. The Delinquent lease would fall into this category and would be included in the schedule for public filing on the proceeding.**

Commented [la49]: Correct, 1 mark

Commented [la50]: Correct, 1 mark

Commented [la51]: Incorrect, the margin loan is a securities contract that is exempt from the automatic stay so the broker can sell the shares after the petition is filed.

Commented [la52]: The debtor would be protected from any action to evict on the basis of unpaid pre-petition rent.

⁴⁶ *In re Village Green I, GP*, 811 F.3d 816, 819 (6th Cir 2016).

(iv) The employment discrimination lawsuit: *On the basis that the employment discrimination lawsuit is not a creditor action, it likely wouldn't be prevented by the automatic stay because its unlikely cause irreparable harm to the estate of Spectrum. It would not be in the public interest if employment discrimination claims could not be brought if there was an ongoing chapter 11 proceeding. However, it might be relevant to consider what relief / damages are claimed because if those are significant then that might have an impact.*

Commented [la53]: Incorrect, this is a civil action for damages so it would be stayed.

* End of Assessment *