

TOTAL = 32/50
64%



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]: 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.

Commented [FV3]: 0, correct answer is D

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.

Commented [FV4]: 0., correct answer is E

Question 1.5

Which of the following regarding executory contracts is false?

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

Commented [FV5]: 1, correct

Question 1.6

Which of the following is not a requirement to confirm a "cramdown" plan?

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

Commented [FV6]: 1, correct

Question 1.7

Which of the following statements about "pre-packs" is false?

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

Commented [FV7]: 1, correct

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]: 1, correct

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]: 0, correct answer is C

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]: 0, correct answer is B

QUESTION 2 (direct questions) [10 marks]

Question 2.1 (1 mark)

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

Idem stated that "Setoff permits a creditor holding a claim against the debtor and simultaneously owing money to the debtor to net out the two (or more) obligations. Further, the Bankruptcy Code exempts the exercise of rights of setoff arising under the non-bankruptcy law from avoidance as preferences under certain circumstances."

Commented [FV11]: 1, correct

Setoff is not permitted in various circumstances due to setoff rights having the ability to improve the position of the creditor in comparison to other unsecured creditors who are not owed money by the debtor "because 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".

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?

US chapter 11 bankruptcies are very expensive for debtors.

In circumstances where a debtor cannot obtain the appropriate finance, a court may grant a priming lien "that is senior to or equal to a pre-petition lien on estate property to secure post-petition financing".

Commented [FV12]: 1.5. Full credit not given because answer fails to note that priming is only granted if DIP is not otherwise available

In order to qualify for the granting of a priming lien, the debtor also must demonstrate that the interest of the secured creditor being primed is adequately protected.

Question 2.3 [2 marks]

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

It is a contempt of court in circumstances where an act taken in violation of the stay has occurred and is voidable. Two potential consequences of a violation of the automatic stay are as follows:

- 1. "the imposition of contempt sanctions against the stay violator, which may include payment of the debtors' attorneys' fees; and**
- 2. Requiring the violator to take affirmative acts to undo the effect of its violation."**

Commented [FV13]: 1. Full credit not given because answer fails to note that act may be void or voidable depending on the Circuit.

For completeness, in circumstances where a court holds concerns that a violator may be delayed in rectifying the violation, the court can "impose coercive contempt sanction, for example, a daily fine to be paid to the court until the stay violation has been rectified".

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?

In voting on a plan of reorganization:

- An unimpaired class is deemed to accept the plan;**
- A class that will receive nothing is deemed to reject the plan; and**
- only impaired classes are permitted to vote on the plan.**

Commented [FV14]: 2, correct

Pursuant to Chapter 11 of the USC ss 1126(c) and (d), "a given class of creditors approves the plan if a simple majority of the creditors in the class, holding at least two-thirds of the value of claims in the class, vote in favour or, for equity interests, if two-thirds in amount of 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?**

The elements of a preference claim are as follows:

- **a transfer of an interest of the debtor in property;**
- **to or for the benefit of a creditor;**
- **for or on account of an antecedent debt owed by the debtor before such transfer was made.**

Further, I note that preference claims only arise where "the debtor is paying a creditor for pre-existing debt".

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

Pursuant to section 548(b) of the Bankruptcy Code, "a constructive fraudulent conveyance is proven by showing that the debtor received less than reasonably equivalent value in exchange for a transfer or incurrence of obligation and one of the following additional factors was present:

- **the debtor was insolvent at the time of or became insolvent as a result of the transaction;**
- **the debtor was unreasonably undercapitalized for the business or transactions it was engaged in or planning to engage in;**
- **the debtor intended to or believe it would incur debts beyond its ability to pay on maturity; or**
- **the transfer was made to or for the benefit of an insider, or the debtor incurred an obligation under an employment contract with an insider outside the ordinary course of business."**

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

Pursuant to section 548(a) of the Bankruptcy Code, "an actual fraudulent conveyance is proven by showing that the debtor 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". As was held in *Ritchie Capital Management, LLC v Stoeber*, "intent may be proven circumstantially by reference to badges of fraud".

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

Question 3.1 [3 marks]

Commented [FV15]: 2. correct answer to b is also a preference.

Commented [la16]: 11/15 marks

Commented [la17]: 2/3 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.

When does the bankruptcy court enter a final order consistent with the US Constitution?

Pursuant to section 157(1) of the USC, there is a distinction made between "core" and "non-core" matters, in particular, one that "permits bankruptcy judges to hear and determine only core proceedings". Pursuant to 157(2), core proceedings include:

- **matters concerning the administration of the estate;**
- **allowance or disallowance of claims against the estate or exemptions from property of the estate, and estimation of claims or interests for the purposes of confirming a plan under chapter 11, 12, or 13 of title 11 but not the liquidation or estimation of contingent or unliquidated personal injury tort or wrongful death claims against the estate for purposes of distribution in a case under title 11;**
- **counterclaims by the estate against persons filing claims against the estate;**
- **orders in respect to obtaining credit;**
- **orders to turn over property of the estate;**
- **proceedings to determine, avoid, or recover preferences;**
- **motions to terminate, annul, or modify the automatic stay;**
- **proceedings to determine, avoid, or recover fraudulent conveyances;**
- **determinations as to the dischargeability of particular debts;**
- **objections to discharges;**
- **determinations of the validity, extent, or priority of liens;**
- **confirmations of plans;**
- **orders approving the use or lease of property, including the use of cash collateral;**
- **orders approving the sale of property other than property resulting from claims brought by the estate against persons who have not filed claims against the estate;**
- **other proceedings affecting the liquidation of the assets of the estate or the adjustment of the debtor-creditor or the equity security holder relationship, except personal injury tort or wrongful death claims; and**
- **recognition of foreign proceedings and other matters under chapter 15 of title 11.**

In respect of "non-core" proceedings, "the bankruptcy court may hear the non-core proceedings if they are sufficiently related to bankruptcy proceedings, but cannot make a final determination, instead it submits proposed findings of fact and conclusions of law to the district court, to which interested parties may object, for the district court's final decision".

Commented [la18]: Specifically, after the decision in Stern v. Marshall, the bankruptcy court may enter a final order only in the core proceedings specific to the Bankruptcy Code (e.g., a challenge to a petition) or where the parties consent.

For completeness, "at the outset of each motion or pleading, parties must state whether the matter at issue is core or non-core, so that the bankruptcy court can determine the scope of its jurisdiction and power to render a final order or judgment".

Who reviews appeals from bankruptcy court orders?

As was held in *re Schulz Mfg Fabricating Co*, "bankruptcy court orders can be appealed not only by litigants involved in one particular issue, but also other persons who are adversely affected by the ruling and therefore have standing to seek review".

In practice, "appeals from the bankruptcy court are heard by the district court for the district court in which they sit. However, in certain circuits, bankruptcy appeals are head by a Bankruptcy Appellate Panel (BAP), convened from the judges of the bankruptcy courts within the circuit. In those circuits, a party has the option to request that the appeal be heard by the district court instead."

Commented [la19]: Correct, 1/2 mark

Commented [la20]: Correct, 1/2 mark

For completeness, from an appeal heard by the district court or BAP, there is a further appeal of right which is heard by the circuit court of appeals.

Pursuant to section 28 USC s158(d), in some rare circumstances, an appeal from a bankruptcy court may go directly to the court of appeals for certification. "The court of appeals has discretion whether to accept a case so certified".

What is the process for reviewing orders that are not constitutionally final?

Whilst an order that resolves an entire dispute and therefore would be final for purposes of an appeal, that order may not be final in the constitutional sense if it is the case that the parties have not consented to the bankruptcy court's jurisdiction.

In these circumstances, if the initial ruling was "in noncore proceeding or the bankruptcy court otherwise did not have authority to enter a final order, the district court or BAP reviews *de novo* all findings of fact and conclusions of law to which a party has objected. The order of the district court or BAP is reviewed by a circuit court of appeal *de novo* as to conclusions of law and for abuse of discretion for findings of fact."

Commented [la21]: Correct, 1 mark

Question 3.2 [3 marks]

Commented [la22]: 0/3 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?

Pursuant to 11 USC s1515(a) "a case under chapter 15 is commenced only by the filing of a petition by the foreign representative of the debtor". In other words, the debtor cannot be placed in chapter 15 voluntarily by a creditor filing.

Commented [la23]: The foreign representative is not able to access the avoidance powers under the Bankruptcy Code. It can bring equivalent claims under applicable US or foreign law or can access the avoidance powers by commencing a plenary proceeding.

However, pursuant to section 1520(a)(1), "the filing of the petition, does not automatically invoke a stay of creditor action; the stay arises only upon the petition for recognition of a foreign main proceeding being granted and is limited to the property of the debtor within the territorial jurisdiction of the United States."

To this end, pursuant to section 1519, "the Bankruptcy Court may grant a stay or other assistance on an interim bases pending recognition or following recognition of a non-main proceeding."

Pursuant to section 101(23), "the requirements of recognition are minimal: the foreign representative must establish that a foreign court or administrative proceeding with respect to the debtor is pending and that the foreign representative is empowered to act by the proceeding."

Question 3.3 [4 marks]

Commented [la24]: 4/4 marks

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

One should review:

- 1. the Bankruptcy rules;**
- 2. the Federal Rules of Civil Procedure;**
- 3. the local rules of the bankruptcy court; and**
- 4. the judge's personal practices.**

Commented [la25]: Correct, 1 mark

Commented [la26]: Correct, 1 mark

Commented [la27]: Correct, 1 mark

Commented [la28]: Correct, 1 mark

The the Federal Rules of Bankruptcy Procedure govern procedures in bankruptcy proceedings (Bankruptcy Rules).

Further, the Bankruptcy Rules "frequently incorporate by reference the Federal Rules of Civil Procedure, particularly with respect to litigation of disputed issues in contested matters or adversary proceedings".

Practitioners should review the relevant local rules of procedure with respect to the bankruptcy court.

Finally, "each judge issues personal practices, which are periodically updated, all available on the website of the bankruptcy court. The local rules and practices not only contain preferred working procedures of the judges, but can modify deadlines for filing and responding to pleadings."

Question 3.4 [5 marks]

Commented [la29]: 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?

In the ordinary course of business, the fiduciary duties owed by directors of Delaware are as follows:

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

Commented [la30]: Correct, 1 mark

Commented [la31]: Correct, 1 mark

Directors of Delaware corporations owe the abovementioned duties to:

- the **corporation and its shareholders**, but not creditors, "even in circumstances where the corporation is potentially insolvent and therefore the shareholder stand to receive nothing in bankruptcy".

Commented [la32]: Correct, 1 mark

Commented [la33]: Correct, 1 mark

Commented [la34]: Correct, 1 mark

As was held in *North Am Catholic Educational Programming Foundation, Inc v Gheewalla*, "individual 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".

Further, in *Trenwick Am Litig Trust v Ernst and Young, LLP*, it was held that "Delaware law imposes no absolute obligation on the board of a company that is unable to pay its bill to cease operations and to liquidate. Even when the company is insolvent, the board may pursue, in good faith, strategies to maximize the value of the firm".

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

Commented [la35]: 8.5/15 marks

Question 4.1 [5 marks]

Commented [la36]: 2/5

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?

Executory Contract - unexpired lease to iWork Ltd

Based on the facts provided, the subject lease has not yet expired. Pursuant to section 365 of the Bankruptcy Code, a debtor has the "ability to assume, reject or assume and assign executory contracts". Put simply, an 'executory contract' is a contract in which "there are material unperformed obligations" by both parties to the agreement. In the

case of iWork Ltd, based on the facts provided, there is rent owing by the lessee (iWork Ltd) to the lessor of the office building.

Debtor provisions under the Bankruptcy Code

A chapter 11 debtor is protected by the automatic stay from most creditor actions. A lessor may generally not demand, terminate a lease or enter the leased premises, once its tenant has filed bankruptcy.

Further, a chapter 11 debtor will be afforded some time, being at least 120 days, to decide whether to assume, or reject, a lease pursuant to section 365(d)(4) of the Bankruptcy Code as follows:

" (4)

(A) Subject to subparagraph (B), an unexpired lease of nonresidential real property under which the debtor is the lessee shall be deemed rejected, and the trustee shall immediately surrender that nonresidential real property to the lessor, if the trustee does not assume or reject the unexpired lease by the earlier of–

- (i) the date that is 120 days after the date of the order for relief; or**
- (ii) the date of the entry of an order confirming a plan.**

(B)

- (i) The court may extend the period determined under subparagraph (A), prior to the expiration of the 120-day period, for 90 days on the motion of the trustee or lessor for cause.**
- (ii) If the court grants an extension under clause (i), the court may grant a subsequent extension only upon prior written consent of the lessor in each instance."**

Lessor Protections pursuant to section 365 of the Bankruptcy Code

In certain circumstances, which may be relevant in the case of iWork Ltd, "a debtor may be deemed to have assumed a contracted based on its conduct, such as when a debtor continues to occupy lease premises despite purporting to reject the unexpired lease".

However, if iWork Ltd opts to reject the unexpired lease, then pursuant to section 365(g)(i) of the Bankruptcy Code, "the rejection of an... unexpired lease of the debtor constitutes a breach of the... unexpired lease".

Alternatively, if iWork Ltd "assume" the unexpired lease, then it must "cure defaults and give the" Lessor sufficient assurance of its future performance as set out below.

"If there has been a default in an... unexpired lease of the debtor (iWork Ltd), as is the case with respect to iWork Ltd, then the trustee may not assume such... lease, unless, at the time of assumption of such... lease, the trustee

Commented [la37]: Correct, 1 mark

Commented [la38]: Correct, 1 mark

Commented [la39]: The debtor must pay post-petition rent as an administrative expense. The landlords have an unsecured claim for pre-petition unpaid rent, and if the lease is assumed and then rejected, there is an administrative priority claim for 2 years' rent.

- (a) *cures, or provides adequate assurance that the trustee will promptly cure such default... except that if such default arises from a failure to operate in accordance with a nonresidential real property lease, then such default shall be cured by performance at and after the time of assumption in accordance with such lease, and pecuniary losses resulting from such default shall be compensated in accordance with this paragraph...;*
- (b) *compensates, or provides adequate assurance that the trustee will promptly compensate, a party other than the debtor to such... lease, for any actual pecuniary loss to such party resulting from such default; and*
- (c) *provides adequate assurance of future performance under such... lease."*

Question 4.2 [5 marks]

Commented [la40]: 3.5/5 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.

Pursuant to section 101(23) of the Bankruptcy Code, 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 adjustments of debt in which the assets and affairs of the debtor are subject to control or supervision by a foreign court, for the purpose of recognition or liquidation".

English schemes of arrangement have been granted recognition having regard to the definition set out under section 101(23) of the Bankruptcy Code.

The requirements for recognition under chapter 15 are outlined in section 1517(a) of the Bankruptcy Code as follows:

- 1. the foreign court or administrative proceeding with respect to the debtor is pending; and*
- 2. that the foreign representative is empowered to act by the proceeding.*

It is not essential for a foreign proceeding to resemble a US bankruptcy case in order to be recognized. Pursuant to section 101(23) of 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". I note that, under this definition "proceedings as diverse as English schemes of arrangement have been granted recognition".

Assuming that Skin Luxe proceed to use an English Scheme of arrangement to structure its bonds, being a reorganization of its debts, then that scheme would be granted recognition under chapter 15 of the Bankruptcy Code.

I note that, in the case of *In re Global Cord Blood Corp*, it was held that "where the foreign proceeding is commenced solely for the purposes of investigation and not for the adjustment of debts, recognition may be denied as failing to meet the chapter 15 definition."

Based on the facts provided, it appears that Skin Luxe intends to use the English scheme of arrangement to restructure the bonds and not solely for the purposes of investigation only, therefore eliminating the risk of denial of recognition under chapter 15 in this regard.

In terms of whether the recognition will be granted under US chapter 15 as a foreign main or foreign non-main proceeding, the case of *Morning Mist Holdings Ltd v Krys (In re Fairfield Sentry Ltd)*, 714 F.3d 127, 133-34 (2d Cir 2013) provides some clarity as to matters considered by the court. In *Morning Mist Holdings Ltd*, it was held that "foreign main proceedings are those that are commenced in the debtor's center of main interests (COMI). COMI is a concept foreign to US law... which typically uses the concepts of domicile, principal place of business, and location of assets in determining jurisdiction and venue".

Commented [la41]: Correct, 1 mark

Pursuant to section 1516(c) of the Bankruptcy Code, "a debtor's COMI is presumed to be its place of incorporation, but this is rebuttable".

Commented [la42]: Correct, 1 mark

As was held in the case of *re SPhinX, Ltd*, 351 BR 103, 117 (Bankr SDNY 2006), "Relevant factors in the COMI analysis include:

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

Further, as was held in *Morning Mist Holdings Ltd*, "a debtor's COMI should be ascertainable by its creditors or other third parties on the basis of objective evidence."

Based on the facts provided in respect of Skin Luxe, the scheme would be recognized as a foreign non-main proceedings as Skin Luxe only has an 'establishment' in the US, being a boutique in Las Vegas.

Commented [la43]: Partially correct, 1/2 mark, the relevant establishment is the boutique in London because that is the jurisdiction where the foreign proceedings are pending for recognition as foreign non-main.

Skin Luxe is incorporated and has a principal place of business in France where it develops and manufactures high end skincare products, therefore France is the appropriate COMI.

Commented [la44]: Correct, 1 mark

For completeness, pursuant to section 1521 of the Bankruptcy Code, relief may be granted upon recognition of a foreign non-main proceeding, on a discretionary basis as follows:

- **"authorization of discovery regarding the debtor's assets and affairs;**
- **entrusting administration of the debtor's US assets to the foreign representative or other person;**
- **extension of provisional relief;**
- **any other relief "necessary to effectuate the purposes of Chapter 15 and to protect the assets of the debtor or the interests of creditors".**

Question 4.3 [5 marks]

Commented [la45]: 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?

Speculation Inc has filed a chapter 11 petition pursuant to section 301 of the Bankruptcy Code, being a voluntary filing with the Bankruptcy Court.

In a chapter 11 petition filed by Speculation Inc (voluntary proceeding), Speculation Inc has the ability "to reject burdensome contracts, sell assets free and clear of liens and pursue claims for recovery of preferential or fraudulent transfers to increase the value of the estate for creditors".

Pursuant to section 362 of the Bankruptcy Code, "except as provided in subsection (b) of that section, a petition filed under section 301... operates as a stay, applicable to all entities of:

Commented [la46]: Correct, 1 mark

- (1) **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;

- (2) the enforcement, against the debtor or against property of the estate, of a judgment obtained before the commencement of the case under this title;**
- (3) any act to obtain possession of property of the estate or of property from the estate or to exercise control over property of the estate;**
- (4) any act to create, perfect, or enforce any lien against property of the estate;**
- (5) any act to create, perfect, or enforce against property of the debtor any lien to the extent that such lien secures a claim that arose before the commencement of the case under this title;**
- (6) any act to collect, assess, or recover a claim against the debtor that arose before the commencement of the case under this title;**
- (7) the setoff of any debt owing to the debtor that arose before the commencement of the case under this title against any claim against the debtor; and**
- (8) the commencement or continuation of a proceeding before the United States Tax Court concerning a tax liability of a debtor that is a corporation for a taxable period the bankruptcy court may determine or concerning the tax liability of a debtor who is an individual for a taxable period ending before the date of the order for relief under this title."**

I set out below the effect of a chapter 11 petition being filed by Speculation Inc, in particular, with respect to the automatic stay, on each of (i) the DOJ investigation, (ii) margin loan default; (iii) the delinquent lease and (iv) the employment discrimination lawsuit.

The Department of Justice (DOJ) Investigation

The DOJ has announced an investigation into whether the success of Speculation Inc was due to illegally trading on insider information.

Pursuant to section 362(b)(4) of the Bankruptcy Code, "the filing of a petition under section 301... of this title... does not operate as a stay of the commencement of an action by a governmental unit..."

Therefore, the DOJ is empowered under the Bankruptcy Code to continue with its investigation into Speculation Inc.

The margin loan default

Commented [la47]: Correct, 1 mark

Speculation Inc funds its trading through a margin loan from its broker and purchases shares that are held as collateral for the margin loan. Speculation Inc has had serious trading losses, causing its broker to declare a default on margin loan.

In the event that the preference of Speculation Inc is to reinstate the margin loan with its broker, Speculation Inc will need to specify in its plan, how it intends to "cure" the outstanding debt pursuant to section 1123(5)(G) of the Bankruptcy Code.

Further, pursuant to section 1124(2)(A) of the Bankruptcy Code, "notwithstanding any contractual provision or applicable law that entitles the holder of such claim or interest to demand or receive accelerated payment of such claim or interest after the occurrence of a default - cures any such default that occurred before or after the commencement of the case under this title..."

Therefore, Speculation Inc will be required to "cure" (as set out in a plan) the debt owing to the broker in order to have the margin loan reinstated.

Commented [la48]: Incorrect, the margin loan is a securities contract exempt from the automatic stay so the broker can sell the shares.

The delinquent lease

Speculation Inc has also fallen behind on its rent.

In the event that the lease (under which the rent becomes due and payable) has not yet expired, then that rent becomes the subject of an executory contract, being an unexpired lease pursuant to section 365 of the Bankruptcy Code.

Commented [la49]: The automatic stay bars the landlord from commencing eviction proceedings on account of the unpaid rent.

In terms of how the delinquent lease will be dealt with under a Chapter 11 proceeding, pursuant to the relevant sections and subsections of the Bankruptcy Code, Speculation Inc could elect to:

- **"reject the contract. the effect of rejection is that Speculation Inc is deemed to have breached the contract immediately before the petition date, giving the lessor an un-secured pre-petition claim in damages;**
- **assume the contract. to assume the contract, Speculation Inc must cure defaults (ie pay the outstanding rent) and give the lessor sufficient assurance of its performance;**
- **assume and assign the contract. transfer the debtor's rights under the contract to a third party. Such transferee must give the counterparty adequate assurances of future performance".**

In the event that Speculation Inc continues to occupy the leased office space, then it may deemed to have assumed the contract based on its conduct.

The employment discrimination lawsuit

Speculation Inc has been sued in civil suit by a former employee alleging she was fired due to due to gender bias.

Pursuant to section 362(a)(1) of the Bankruptcy Code, the law suit filed by the former employee will be stayed on the basis that the former employee commenced the proceeding against Speculation Inc which could have been commenced before the filing of the petition.

Commented [la50]: Correct, 1 mark

Subchapter V of Chapter 11

For completeness, based on the facts provided with respect to Speculation Inc, it remains unclear as to the quantum of the debts and/or whether it is small business under Subchapter V of Chapter 11. I note that "Subchapter V of chapter 11, added to the Bankruptcy Code by the Small Business Reorganization Act of 2019, creates a modified chapter 11 proceeding for businesses with debts below a statutory threshold which is current USD 7,500,000".

* End of Assessment *