

TOTAL = 37/50  
74%



**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]: 1, correct

#### Question 1.2

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

- (a) A shareholder in Parts Inc, to which Car Corp is indebted.
- (b) A journalist writing about Car Corp's bankruptcy.
- (c) A shareholder in Investment Corp, Car Corp's parent company.
- (d) A retired employee of Car Corp who receives payments from the company's pension plan.
- (e) A non-profit organization that advocates for companies like Car Corp to be held responsible for climate change

Commented [FV2]: 1, correct

#### 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.

Commented [FV7]: 0, correct answer is A

(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.

Commented [FV8]: 0, correct answer is E

(d) Both options (a) and (b).

(e) Both options (a) and (c).

**Question 1.9**

Which of the following about 363 sales is false?

(a) A good faith purchaser at a 363 sale may retain the property notwithstanding a subsequent reversal of court approval for the sale on appeal.

(b) The debtor-in-possession must establish that the transaction is in the best interests of the estate as a whole.

(c) In chapter 15 proceedings, a foreign court's approval alone suffices for a 363 sale.

Commented [FV9]: 1, correct

(d) Debtors must carry out a robust marketing process for the sale.

(e) A creditor's lien on assets sold in a 363 sale attaches to the proceeds of the sale.

### Question 1.10

Which of the following regarding substantive consolidation is true?

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

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?

The doctrine of setoff is the ability of a creditor holding a claim against a debtor while also owing money to said debtor. Setoff allows the obligations to net or cancel each other out to offset mutual debts. While setoff can be a helpful tool, there are certain situations set out in the Bankruptcy Code that do not allow the exercise of rights of setoff arising under non-bankruptcy law from avoidance as preferences.<sup>1</sup> This is because setoff can provide an advantage of one creditor over another unsecured creditor who is not owed money.<sup>2</sup> Setoff also has the potential to generally complicate the administration of a bankruptcy case, particularly in circumstances where there are legal challenges to the transaction.

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?

The cost of being a debtor can be quite costly in US chapter 11 bankruptcy as there are associated ongoing post-petition costs (i.e. lawyers, advisors, other payments). As such, debtors have available to them debtor in possession (DIP) financing to facilitate successful restructuring of the debtor.

Permission to obtain a priming lien may be granted by the Court for post-petition financing costs and it must be demonstrated that it is necessary for the continued operation of the business and in the best interest of the estate.

A priming lien is a "lien on a property senior to, or with the same priority as, existing liens on the same property" and is only available as a last resort to other DIP financing.<sup>3</sup> It must also be demonstrated by the debtor that interest of the secured creditor being "primed" is provided adequate protection and security.<sup>4</sup>

Commented [FV12]: 2, correct

<sup>1</sup> Title 11 of United States Code, § 553.

<sup>2</sup> L R Hall, "Module 3A Guidance Text, Insolvency System of the United States", p 59.

<sup>3</sup> <https://uk.practicallaw.thomsonreuters.com/4-383-2771>.

<sup>4</sup> Hall, *supra* note 2, p 30.

**Question 2.3 [2 marks]**

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

The purpose of the automatic stay<sup>5</sup> is to provide the debtor with breathing room to formulate and implemented a restructuring plan with creditors in accordance with the Bankruptcy Code.

Violation of the stay can occur in a number of circumstances. For example: (i) 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;<sup>6</sup> and (ii) the setoff of any debt owing to the debtor that arose before the commencement of the case under the Bankruptcy Code against any claim against the creditor.<sup>7</sup>

Commented [FV13]: 2 correct

Violation of the stay constitutes contempt of court and is void or voidable. Also, failure to obtain relief from the stay may result in imposition of contempt sanctions against the (stay) violator. This can be done through a lift-stay or relief from stay motion.<sup>8</sup> The violating party may also be at risk for costs of the debtor who suffers harm in the form of monetary damages from the court (i.e. actual loses, costs, attorney's fees, even punitive damages).

**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, the US Bankruptcy Code provides both the requirements of a plan for the corporate debtor and other aspects which may be required.

Creditors or interests held by creditors are typically classified into the following categories: (i) creditors secured by real property; (ii) creditors secured by personal property; (iii) unsecured creditors; and (iv) shareholders (equity). From there, the classes must be further specified as "unimpaired" or "impaired".<sup>9</sup>

Only impaired classes are permitted to vote. Conversely, where a given class of creditors is unimpaired by the plan, they are considered to have accepted the plan without needing to vote. Whereas if a class of impaired creditors do not vote to accept the plan, then they are considered to have rejected the plan.<sup>10</sup>

Commented [FV14]: 1.5. Full credit not given because answer fails to not that class that receives nothing is deemed to have rejected the plan

In terms of acceptance, a plan generally requires "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" (i.e. cramdown).<sup>11</sup>

**Question 2.5 [3 marks]**

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

<sup>5</sup> 11 USC, §362.

<sup>6</sup> *Ibid*, §362(a)(3).

<sup>7</sup> *Ibid*, §362(a)(7).

<sup>8</sup> Hall, *supra* note 2, pp 22 to 24.

<sup>9</sup> *Ibid*, p 38.

<sup>10</sup> 11 USC, §1126.

<sup>11</sup> Hall, *supra* note 2, p 40; 11 USC, §§ 1126(c) and (d).

- (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?

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

11 USC §547 prescribes a preference action which allows to avoid certain preferential transfers made by the debtor before the filing of bankruptcy. The elements of a preference claim are (i) a transfer of an interest of the debtor in property (ii) to or for the benefit of a creditor (iii) for or on account of an antecedent debt owed by the debtor before such transfer was made (iv) made while the debtor was insolvent (v) made during the suspect period (vi) that enables the creditor to receive more than it would have in a chapter 7 liquidation.

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

A constructive fraudulent conveyance action requires the debtor to be presumed or proven to have been insolvent at the time of the transfer. Fraudulent transfers and obligation are governed by 11 USC §548(b) where it must be shown that the debtor received less than reasonably equivalent in value in exchange for a transfer or occurrence of obligation. Whether the transfer occurred while the debtor was insolvent or caused its insolvency is an additional factor.

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

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

An actual fraudulent conveyance action<sup>12</sup> 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."<sup>13</sup> The intention to "frustrate" the recovery may also be proven circumstantially by relying on badges of fraud such as was in the case of *Ritchie Capital Mgmt, LLC v Stoebner*.<sup>14</sup>

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

Commented [la16]: 12.5/15 marks

**Question 3.1 [3 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.

The US Bankruptcy courts are a product of federal legislation,<sup>15</sup> as opposed to creation by way of Article III of the US Constitution. This has resulted in US Supreme Court decisions which have held that judges who have not been appointed by way of Article III, are unable to exercise jurisdictions over matters subject to Article III (i.e. certain non-bankruptcy claims and matters).<sup>16</sup> Referral statute confirmed that bankruptcy judges are only permitted to have

<sup>12</sup> 11 USC, §548(a)(1)(A).  
<sup>13</sup> Hall, *supra* note 2, p 57.  
<sup>14</sup> 779 F.3d 857 (8th Cir 2015).  
<sup>15</sup> 1978 Bankruptcy Code.  
<sup>16</sup> Hall, *supra* note 2, p 16.



jurisdiction over "core" proceedings (as opposed to non-core proceedings, discussed further below).<sup>17</sup>

Bankruptcy judges have authority to enter final orders in core proceedings it is presiding over which are related, but not limited to, the administration of the estate (and proceedings generally), allowance and disallowance of claims, counterclaims by the estate against claims against the estate, proceedings in relation to preferences, confirmations of plans, recognition of foreign proceedings and other matters.<sup>18</sup> Where bankruptcy judges lack authority and need to determine a core proceeding in which they lack constitutional authority over, the US Supreme Court held in the case of *Executive Benefits Ins Agency v Arkison*,<sup>19</sup> that it may issue a report and a recommendation for review by the district court. This is the same procedure as in non-core proceedings, or, with the consent of the parties may issue final orders.<sup>20</sup>

Appeals from Bankruptcy Court orders depends on whether an order is final for the purposes of appeal. Bankruptcy Court orders may be appealed by litigants (parties to the proceedings), or other persons adversely affected by the decision. Final orders are appealed as of right and interlocutory orders may only be appealed with leave from the appellate court. Appeals from bankruptcy courts are heard by the district court for their district, or a Bankruptcy Appellate Panel (BAP). A further appeal may be made as of right to the circuit court of appeals. And in certain circumstances to the court of appeals if the district court certifies that the (i) appeal raises a question 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.<sup>21</sup>

Where orders are not constitutionally final, parties may seek leave which involves seeking permission from the bankruptcy court or appellate court. They may also seek review by the district court or BAP, but this will also be specific to the jurisdiction and district involved.

### 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?

A foreign representative is recognized under chapter 15 and the US bankruptcy courts and is provided certain powers to facilitate coordination in a cross-border insolvency proceeding. Despite the chapter 15 code following the UNCITRAL Model Law on Cross-Border Insolvency (Model Law) very closely, chapter 15 excludes from the rights granted to foreign representatives the use of avoidance powers available in the Bankruptcy Code (11 USC, §§544, 545, 547, 548, 550 and 724(a)).<sup>22</sup> A foreign representative can only invoke avoidance powers under chapters 7 or 11 of the Bankruptcy Code.<sup>23</sup>

### Question 3.3 [4 marks]

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

<sup>17</sup> 28 USC, §157 and 1134.

<sup>18</sup> *Ibid*, §157(b)(2).

<sup>19</sup> 134 S.Ct 2165 (2014).

<sup>20</sup> Hall, *supra* note 2, p 18; *Wellness Int'l Network, Ltd. v Sharif*, 135 S Ct 1932 (2015).

<sup>21</sup> 28 USC, §158(d).

<sup>22</sup> Hall, *supra* note 2, p 66.

<sup>23</sup> 11 USC, §1523(a).

**Commented [la18]:** Partially correct, 1/2 mark, after the decision in *Stern v. Marshall*, this is limited to core proceedings exclusive to the Bankruptcy Code, like a challenge to a petition

**Commented [la19]:** Correct, 1 mark

**Commented [la20]:** Correct, 1 mark

**Commented [la21]:** 2/3 marks

**Commented [la22]:** Correct, 1 mark

**Commented [la23]:** Correct, 1 mark; also the foreign representative can bring equivalent claims under applicable US and foreign law.

**Commented [la24]:** 4/4 marks

As mentioned above, the Bankruptcy Code is a creature of statute rather than the rights under Article III of the US Constitution. Therefore there are a number of other sources of law in which practitioners and litigants should review when preparing a filing for a bankruptcy court, specifically: (i) the Bankruptcy Code (Title 11 of the United States Code); (ii) the Federal Rules of Civil Procedure; (iii) local rules of the bankruptcy court; and (iv) the local judge's personal practices. In addition, foreign, state and federal laws may also determine the rights of debtors and creditors unless otherwise specified in the Bankruptcy Code.

Commented [la25]: Correct, 1 mark

Commented [la26]: Correct, 1 mark

Commented [la27]: Correct, 1 mark

The Federal Rules of Procedure and Federal Rules of Bankruptcy Procedure govern the process and procedures that a bankruptcy court follows to carry out the Bankruptcy Code.

Commented [la28]: Correct, 1 mark

Chapters 1, 3 and 5 of the Bankruptcy Code set out general provisions and case administration provisions applicable under chapters 7, 11, 12, 13 and 15. This includes definitions, who is eligible to be a debtor, powers of a trustee/debtor in possession, defines certain rights of creditors, debtors and estates in proceedings. However, not all key terms are defined and one must look to case law or alternative legislation outside of the Bankruptcy Code.

Chapter 7 relates to liquidations general procedures, whereas Chapter 11 is applicable to reorganization proceedings (for large corporations and small businesses – see Subchapter V added by the Small Business Reorganization Act).

Chapter 15 is the product and enactment of the UNCITRAL Model Law (with certain modifications) and sets out the procedures for recognition of foreign proceedings and coordination of US and foreign proceedings.

In terms of opening insolvency proceedings, one must first establish the minimum requirement to be a debtor being the presence of the debtor or its place of business or any assets in the United States – including intangible assets or a retainer paid to attorneys.<sup>24</sup>

Commencement of insolvency proceedings should be in accordance with the applicable chapter the debtor seeks relief under i.e. liquidation (chapter 7) or reorganization (chapter 11). Guidance for the commencement of a case general can be found under 11 USC Subchapter 1 §301 to §308. Proceedings are then considered voluntary or involuntary under any applicable chapter by filing a petition, and the filing party should consider all electronic filing requirements.<sup>25</sup> There may also be certain schedules applicable to the relevant filing.

#### Question 3.4 [5 marks]

Commented [la29]: 4/5 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?

Generally, the liability of directors is a matter of state law and state of incorporation. With a focus on fiduciary duties for directors of Delaware corporations, directors owe a fiduciary duty of loyalty, including good faith, oversight and disclosure. However, they are protected from liability for errors of judgement by the business judgment rule.<sup>26</sup>

Commented [la30]: Correct, 1 mark, they also owed a duty of care

Delaware often applies the business judgment rule which presumes directors to have acted in good faith the basis of reasonable information. This presumption can be a defense for directors but can be rebutted (and may not be liable in gross negligence) by showing conversely that the majority of the board were not reasonably informed, not honestly make a decision in the

<sup>24</sup> 11 USC, §109.

<sup>25</sup> *Ibid*, §301.

<sup>26</sup> Hall, *supra* note 2, p 60.

best interest of the corporation, or not acting in good faith. Under Delaware General Corporate Law of the Delaware Code Title 8 Subchapter I, directors may be 'exculpated' by a corporation's certificate of incorporation from liability for breach of duty of care, but not for breach of duty of loyalty.<sup>27</sup>

In the case of *North Am Catholic Educational Programming Foundation, Inc v Gheewalla*,<sup>28</sup> it was found by the Delaware Supreme Court that, "Individual creditors of an insolvency corporation have no right to assert direct claims for breach of fiduciary duty against corporate direction. Creditors may nonetheless protect their interest by bringing derivative claims on behalf of the insolvent corporation." As such there is authority that directors owe duties to the corporation and its shareholders, not to creditors even when a company is operating "in the zone of insolvency" or insolvent.<sup>29</sup>

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

##### Question 4.1 [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?

There are certain protections under the Bankruptcy Code for lessors of office space when corporations such as iWork Ltd find themselves in the zone of insolvency or otherwise contemplating bankruptcy.

In the event iWork Ltd were to file for bankruptcy protection, the lessor would be able to seek relief from the automatic stay to pursue remedied for non-payment of rent i.e. pre-petition rent.<sup>30</sup>

A lease is considered an executory contract and the Bankruptcy Code provides for the ability to assume, reject or assume and assign executory contracts. In the event iWork filing chapter 7 proceedings for liquidation or chapter 11 for reorganization, decisions by the trustee or debtor to assign or reject unexpired leases of non-residential property are required to be made within 120 days of the for the order for relief.<sup>31</sup> This timeline can ultimately be extended to 90 days for cause but any further extension requires the consent of the lessor.

The Bankruptcy Code further permits that in the circumstances that the debtor rejects the lease or the court grants relief from the stay, the lessor may choose between (i) considering the lease terminated or (ii) remaining in possession and continuing to receive any rents due and owing.<sup>32</sup>

The requirements for the debtor to acknowledge the unexpired lease on filing of the petition is prescribed by the Bankruptcy Code and the relevant schedules which would be required.<sup>33</sup>

<sup>27</sup> Del Gen Corp L, §102(b)(7).

<sup>28</sup> 930 A.2d, 103 (Del 2007).

<sup>29</sup> Hall, *supra* note 2, p 60.

<sup>30</sup> 11 USC, §362.

<sup>31</sup> *Ibid*, §365(d)(4).

<sup>32</sup> *Ibid*, §365(h).

<sup>33</sup> *Ibid*, §521.

Commented [la31]: Correct, 1 mark

Commented [la32]: Correct, 1 mark

Commented [la33]: Correct, 1 mark

Commented [la34]: 10/15 marks

Commented [la35]: 2/5 marks

Commented [la36]: This would usually be resolved as an unsecured claim in the bankruptcy rather than a basis to lift the stay.

Commented [la37]: Correct, 1 mark

Commented [la38]: Correct, 1 mark

Commented [la39]: The lessor has an administrative priority claim for post-petition rent and administrative priority claim for 2 years' rent if the debtor assumes and then rejects the lease.

As the lease with iWork Ltd. is considered as arising as a pre-petition claim, the creditor will then file a proof of claim on or before the bar date from the court.<sup>34</sup> The claim is deemed allowed unless objected to.

**Question 4.2 [5 marks]**

Commented [la40]: 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.

Chapter 15 of the Bankruptcy Code provides a framework for recognition of foreign insolvency proceedings as foreign main proceedings or foreign non-main proceedings. As discussed above, chapter 15 incorporates the UNCITRAL Model Law on Cross-Border Insolvency, near verbatim.<sup>35</sup> In order to consider whether the English scheme of arrangement could be granted recognition under US chapter 15, we must first consider the requirements for recognition as a foreign main or foreign non-main proceeding individually.

In order to be recognized as a foreign main proceeding, the English scheme of arrangement must be the primary insolvency proceeding in which the debtor's assets and affairs are being administered. The fact pattern advises that Skin Luxe is incorporated and has a principal place of business in France. Foreign proceedings are considered those that are commenced in the debtor's centre of main interest (COMI). A debtor's COMI is considered to be its principal place of business, unless rebutted.<sup>36</sup> In circumstances where Skin Luxe's COMI is considered to be in France where it develops and manufactures high end skin care products, the English scheme may not qualify as a foreign main proceeding. However, depending on any further ancillary facts (not available for this question), there may be scope to analyse Skin Luxe's COMI based on its creditors and other third parties on the basis of objective evidence.<sup>37</sup>

Commented [la41]: Correct, 1 mark

Commented [la42]: Correct, 1 mark

Commented [la43]: Correct, 1 mark

In any event, if the English scheme of arrangement is not recognized under chapter 15 as a foreign main proceeding, there is most likely scope for the matter to be recognized as a foreign non-main proceeding where the proceedings are in a jurisdiction *other than* the debtor's COMI. However, the debtor must have an 'establishment' in the jurisdiction. An establishment is a place where the debtor (Skin Luxe) carries out a non-transitory economic activity.<sup>38</sup> The boutique(s) locations that Skin Luxe operates in London may be sufficient enough to be considered establishments. In the case of *In Creative Finance Ltd.*, the terms "operations" and "economic activity" require a showing of a local effect on the marketplace, more than mere incorporation and record-keeping and more than just the maintenance of property.<sup>39</sup>

Commented [la44]: Correct, 1 mark

Commented [la45]: Correct, 1 mark

With the above said, the English scheme of arrangement is more than likely to be considered foreign non-main proceedings, considering the strong argument that Skin Luxe's COMI is France and it can therefore not be considered the main proceedings. The presence of

<sup>34</sup> *Ibid*, §502.

<sup>35</sup> Hall, *supra* note 2, p 61.

<sup>36</sup> 11 USC, §1516(c).

<sup>37</sup> Hall, *supra* note 2, p 61; *Morning Mist*, 714 F.3d at 134.

<sup>38</sup> 11 USC, §1502(2).

<sup>39</sup> 543 B.R. 498, 520 (Bankr. S.D.N.Y. 2016).

boutiques in London i.e. brick and mortar businesses, may be sufficient for the English scheme of arrangement as foreign non-main proceedings.

**Question 4.3 [5 marks]**

**Commented [la46]:** 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?

A chapter 11 petition in the case of Speculation Inc. would be filed by way of petition and attract various issues and legal proceedings. Below are each of the issues listed above and their effect, answered in turn.

The automatic stay in bankruptcy proceedings is subject to certain statutory exceptions, including a criminal investigation.<sup>40</sup> As such any ongoing DOJ proceedings would continue to proceed through the courts. The bankruptcy court handles primarily civil matters, separate from any other investigations.

**Commented [la47]:** Correct, 1 mark

In relation to the margin loan default, chapter 11 proceedings result in an automatic stay which would ordinarily prevent any attempt to collect on pre-petition claims.<sup>41</sup> The stay would provide Speculation Inc the ability to negotiate with its creditors in its reorganization of its debts. Speculation is also protected by the stay in that the broker is prevented from taking any further action in recovery of its claim.

**Commented [la48]:** Incorrect, the margin loan is a securities contract that is exempt from the automatic stay so the broker can liquidate the collateral.

**Commented [la49]:** Correct, 1 mark

The automatic stay is also brought about in circumstances of a delinquent lease. However, the stay does not protect from eviction of a debtor-tenant from a non-residential property where the lease has expired – this would be determinative on any additional facts in the fact pattern.<sup>42</sup>

**Commented [la50]:** Correct, 1 mark

The employment discrimination lawsuit would continue in the civil courts. The final determination of the claim would form part of the debtor's estate.

**Commented [la51]:** Incorrect, the lawsuit would be stayed by the filing of the petition.

**\* End of Assessment \***

<sup>40</sup> 11 USC, §362(b).

<sup>41</sup> *Ibid*, §362(a).

<sup>42</sup> *Ibid*, §362(b).