

TOTAL = 32.5/50
65%



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).***
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- 6.1 ***If you selected Module 3A as one of your compulsory modules (see the e-mail that was sent to you when your place on the course was confirmed), the final time and date for the submission of this assessment is 23:00 (11 pm) GMT on 1 March 2024. The assessment submission portal will close at 23:00 (11 pm) GMT on 1 March 2024. No submissions can be made after the portal has closed and no further uploading of documents will be allowed, no matter the circumstances.***
- 6.2 ***If you selected Module 3A as one of your elective modules (see the e-mail that was sent to you when your place on the course was confirmed), you have a choice as to when you may submit this assessment. You may either submit the assessment by 23:00 (11 pm) GMT on 1 March 2024 or by 23:00 (11 pm) BST (GMT +1) on 31 July 2024. If you elect to submit by 1 March 2024, you may not***

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

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

ANSWER ALL THE QUESTIONS

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

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

Question 1.1

Car Corp, incorporated and headquartered in Michigan, owes Parts Inc, incorporated and headquartered in Mexico, USD 10,000 on a past-due invoice for components used to build Car Corp vehicles. May Parts Inc file an involuntary petition to place Car Corp into chapter 11 bankruptcy proceedings?

- (a) **Yes, regardless of the circumstances.****
- (b) Yes, if Car Corp has fewer than 12 non-contingent, non-insider creditors.**
- (c) Yes, if other creditors owed at least USD 5,775 join in the petition. [FV1]**
- (d) No, because Parts Inc does not know whether Car Corp is insolvent.**
- (e) No, because Parts Inc is not a US company.**

Question 1.2

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

- (a) A shareholder in Parts Inc, to which Car Corp is indebted.**
- (b) A journalist writing about Car Corp's bankruptcy. [FV2]**
- (c) A shareholder in Investment Corp, Car Corp's parent company.**

- (d) **A retired employee of Car Corp who receives payments from the company's pension plan.**
- (e) **A non-profit organization that advocates for companies like Car Corp to be held responsible for climate change**

Question 1.3

Which of the following entities does not satisfy the minimum presence requirement to be a debtor under any chapter of the Bankruptcy Code?

- (a) **A foreign domiciled company that pays a US attorney a retainer.**
- (b) **A company with several US bank accounts, but no physical presence in the United States.**
- (c) **A company with US patents, but no physical presence in the United States.**
- (d) **Options (a) to (c) above satisfy the minimum requirement for presence in the United States.**
- (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?

- (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.*^[FV5]
- (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? |

^[FV6]

- (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.*

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.** |
- ^[FV7]
(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.*

Question 1.8

If a debtor rejects an executory trademark license agreement under which the debtor licenses its trademark to a manufacturer, which of the following is true:

(a) The manufacturer has a claim for damages for breach of contract.

(b) The manufacturer must immediately stop using the trademark.

[FV8]

(c) The manufacturer can continue using the trademark for the remaining period of the license.

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

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

Question 1.9

Which of the following about 363 sales is false?

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

[FV9]

(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.

Question 1.10

Which of the following regarding substantive consolidation is true?

(a) It respects the boundaries of corporate separateness.

[FV10]

(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.

QUESTION 2 (direct questions) [10 marks]

Question 2.1 (1 mark)

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

ANSWER

In insolvency proceedings related matters a set off is meant to refer knocking off of a pre-petition claim against a debtor with a pre-petition debt owed to the same debtor. The set off is normally discouraged because the size of the estate to that extent will become poorer and the funds available for distribution to the creditors as a whole will become lesser at the cost of one creditor who scores a big advantage.

The set off may not be permissible due to 1) the creditor's claim may not be admissible 2) [FV11] the claim is within the period of 90 days prior to the petition date during which period the debtor is generally considered as insolvent 3) similarly the creditor's obligation to the debtor also took place during a similar period.

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?

ANSWER

Securing the necessary financial assistance to keep the company as a going concern in a debtor in possession reorganization is really a big challenge. Any financier who

extend financial assistance during such a time would expect that they should be given paramount protection for the risk being taken by them. They would expect that their loan should be put in priority in having the primary lien on the property of the corporate debtor or atleast on par^[FV12] with existing lien. The courts, while approving such a loan would expect a) that the corporate debtor did exhaust all other avenues of raising a finance on normal terms; b) that the interest of the other secured creditors is adequately protected; c) that if the finance is from existing creditor by way of rolling up then it should be adequately proved that no other finance was available and d)that the additional financing obtained is really substantial.

Question 2.3 [2 marks]

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

ANSWER

- 1. Any action performed knowingly or unknowingly in violation of the stay of an insolvency court constitutes an act of contempt. It is either void or voidable^[FV13] depending on the court's order.**
- 2. The violator should not only undo the act of violation and set right the position to status quo but also compensate the debtor towards the legal cost met by them in the concerned matter.If there is an apprehension that the violator would delay taking remedial action, then the court can even levy a daily fine paid to the court till the status quo is achieved. However, no other compensation can be claimed by the debtor.**

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?

ANSWER

In voting, the impaired classes of creditors, meaning who have the most to gain or to lose will be participating. ^[FV14]

A plan is deemed accepted if creditors with atleast more than two third of the value of the claim vote in favour. In the case of creditors with equity interests then that class of creditors with two thirds amount need to vote in favour.

Question 2.5 [3 marks]

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

- (a) Which cause of action applies only to transfers made on account of antecedent debt?**
- (b) Which cause of action requires that the debtor be presumed or proven to have been insolvent at the time of the transfer?**
- (c) Which cause of action requires that the debtor be proven to have intended to frustrate creditors' recoveries?**

ANSWER

(a) A delay in perfection of a security interest which is more than 30 days after transfer will ^[FV15] render the debt unenforceable and the payment of such antecedent debts will be treated as preference.

(b) Post the transfer transaction, which took place during the 90 days prior to the petition date, if the insolvency on a balance sheet basis occur, then the debtor is presumed to have been insolvent at the time of transfer.

(c) If the debtor is proved to have received less than reasonably equivalent value in exchange for a transfer or incurrence of obligation such as the debtor intending to or believe it would incur debts beyond it ability to pay on maturity.

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

Question 3.1 ^[1a17] [3 marks]

Describe the circumstances in which a bankruptcy court may enter a final order consistent with the US Constitution, who reviews appeals from bankruptcy court orders and how orders that are not constitutionally final are reviewed.

ANSWER

In every country, including the ones which are following authoritarian system, a model of allowing appeal by a party to a case who feels that justice has not been delivered to him. The appeal system is in place in US also for bankruptcy cases like in civil and criminal cases. Of course there will be a major difference in bankruptcy cases, as it is not a matter between winner and loser.

In bankruptcy cases which is negotiation between the debtors and creditors to reach a compromise in such a way that other stakeholders also gain in the process.

Another important fact to be kept in mind is that bankruptcy courts do not owe their genesis to constitution from where the other federal courts are deriving their powers^[1a18]. They are created by Congress hence the appeal process is different from that of courts with constitutional background

What orders can be appealed?

All final orders of a bankruptcy court such as an order lifting the automatic stay or authorising use of cash collateral etc or a summary judgement can be appealed. In *Re Union Broadcasting Corporation* a final order is explained as " one that resolves the litigation, decides the merits, settles liability establish damages,or even determines the rights any party involved in the case". The other orders are called interlocutory orders which can also be appealed with the lieu of the appellate court.

Where appeal lies?

Before Sec 28 was amended, all appeals went automatically to the district court^[1a19]. The amendment brought in a Bankruptcy Appellate Panels (BAPs)^[1a20] which were constituted with three bankruptcy judges from the same circuit. In whichever circuit has formed the BAPs, the appeals from bankruptcy court would go to them unless otherwise one of the parties decides to opt for appeal before district court. The matters dealt with on appeal are on matter of law, matter of erroneous understanding of facts or acts of indiscretion by the bankruptcy court and the hearings will be de novo, meaning from the beginning.^[1a21]

The appeals from BAP or district court goes to U.S.Court of appeals where also the process is denovo. After passing of the Bankruptcy Abuse and Consumer Protection Act, 2005, (BAPCA) the appeal can be taken directly into U.S.Court of Appeals with the consent of all parties involved and required certification from the court which handled the matter.

An elaborate process has been put in place for appealing in the bankruptcy court's orders, both for interlocutory as well as final orders.

Question 3.2^[1a22][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?

ANSWER

At the outset, though Chapter 15 of the US insolvency code has followed the Model Law on Cross Border Insolvency in many respects, it has also held back some of the

rights from a foreign representative in the case of use of avoidance powers^[1a23] provided under the Act.

Foreign Representative may not invoke the provisions of the Code under the following sections covering avoidance powers under the Bankruptcy Code.

Sec 522 - Exemptions available for a debtor under federal law or state laws.

Sec 544 - gives the trustees the ability to avoid transferring a debtor's property if a creditor would have the same right under the state law.

Sec 545 - avoiding fixing of a statutory lien on property of the debtor

Sec 547 - power to claw back preferential payments made to creditors within 90 days of filing for bankruptcy.

Sec 548 - power to trustees to avoid prepetition transfer of debtor's property and recover.

Sec 550 - recover the property transferred or its value from the initial transferee when the falls under avoidance transactions.

Sec 724(a) - avail avoidance of tax lien but not the penalty component.

However, the idea is not to prevent a foreign representative from seeking relief under prepetition deals and it is to be noted that this provision was already available under Sec 304 of the Insolvency code which is only to apply extra caution.

But at the same time, provisions are available for a foreign representative to commence a plenary proceedings under Chapter 7 or Chapter 11 and put themselves equivalent to debtor who has commenced such a proceedings and thereafter ask for all these reliefs through the plenary proceedings.^[1a24]

Also upon recognition of the proceedings under Chapter 15 either as a foreign main or foreign non-main proceedings, the foreign representative is permitted to intervene any proceedings in the local US state or federal court proceedings to which the debtor is a party.

Similarly the foreign representative's relief to deal with the property of a debtor lying in US in the ordinary course of business and dispose of the same outside the ordinary course of business does not permit the foreign representative to take the funds out of such proceedings into the account of the foreign proceedings for distribution. The granting of such a relief is discretionary by the US courts and the foreign representative should prove the existence of "balance of interest" (as provided under Article 22 of MLCBI which is imbibed in the US code) and that the creditors in US are protected sufficiently.

Question 3.3^[1a25] [4 marks]

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

ANSWER

When preparing a filing for a Bankruptcy Court, the Federal Rules of Bankruptcy procedure^[1a26], referred to in short as **Bankruptcy Rules** need to be followed. Most of the provisions of **Federal Rules for Civil Procedure**^[1a27] with particular reference to litigations in resolving disputes of civil nature are incorporated in to the **Bankruptcy Rules**.

Two types of commencement of proceedings are

a) voluntary - A debtor may commence a filing on his own volition and the rules prescribe that a list of assets and creditors need to be filed along with the application.

b) involuntary - a proceedings commenced by a creditor only under Chapter 7 and 11.

Along with the application or shortly thereafter the following schedules are required to be filed:

Schedule A /B Details of Real and Personal property

Schedule D Details of Secured Creditors

Schedule E/F Details of Unsecured Creditors

Schedule G Executory contracts and unexpired leases

Schedule H Co-debtors

In addition, a list of the 20 largest non-insider creditors to enable the US Trustee to form Unsecured Creditors Committee.

Sufficient publicity about the petition filed and the proceedings should be made amongst the interested parties either by way of e mails where the number of parties are small or by a public announcement in the form and manner as laid down by each bankruptcy court.

The debtor is required to file a list of creditors through the schedules. The creditor also must file a proof of claim within the due date to be eligible for receiving the payment.

Separate set of rules are applicable for each type of proceedings.

Care should be taken to know that each bankruptcy court has also got its own rules and insist following up them by the litigants before them. Besides in the website of a

notice agent, case details need to be updated in the website of the bankruptcy court and details should be provided for the same.

AS an outcome of the Stern vs Marshall's case, there is a requirement that litigants to state in their application whether they consent to the entry of final orders or judgement by the bankruptcy court. In the absence of clarity and filing of no such pleadings, the court can deem it fit to take it that the litigants agree for final order to be issued by the respective bankruptcy courts.

In the case of a small business debtors, rules are different from commencing a proceeding under sub-chapter V under Small Business Reorganization Act and the proceeding under Chapter 11.

Finally, Bankruptcy Code being a federal law supersedes the state law and when they are in conflict the bankruptcy law prevails. At the same time, the provisions under state law such as creditor protections by way of ability to commence receivership or foreclose on property under pledge are not available under Bankruptcy proceedings.

Question 3.4 [1a28][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?

ANSWER

Delaware is taken as a model state with in practicing corporate laws and many other US states are following the same. Directors and board members are appointed by share holders. The concept of one person company is also in practice where that person can be the sole director, treasurer, stock holder and even can be president and secretary.

The director is responsible for leading the company's strategy, appointing officers to manage the day-to-day affairs of the business, overseeing and managing the company and take important corporate decisions on behalf of the share holders.

In discharging their duties, the directors have the fiduciary duties such as care [1a29] and loyalty [1a30] which include subsidiary duties of good faith, oversight and disclosure.

Care requires informed decision making based on ensuring that all material information were collected with reasonable care and diligence.

Loyalty is the other important duty to be exhibited at all times. Every decision to act or desist from acting should be taken on un-detached meaning disinterested in end result but only with the sole aim of delivery to the corporate and its share holders.

Loyalty should also exhibit that every decision is taken independently, though based on material made available.

The decisions taken should also have the following attributes :

- **Good faith**
- **Oversight**
- **Disclosure**

Amongst the above, importance is attached to oversight meaning developing a rule book for the corporate to ensure that all laws of the land are complied with and ensure that the risk is managed by the board by not violating any of the process required. For this purpose, the board should be highly conscious of any item of violation red flagged and ensure not only removal of the same but also avoid recurrence.

The board and directors should always follow the principle of " When in doubt, always disclose" in every one of their deliberations. It is even stated that a director may have some interest in certain decisions being taken but if the record is given that adequate disclosure of such decisions and how it was still overwhelmingly in the interests of the corporate and its share holders. Courts in Delaware have, after scrutinising that such decisions were taken by majority of the overall board, have upheld the action of the interested director also.

The directors also should, while discharging all of the above, followed the business judgement rules so that any one challenging the decision taken or not taken does not get evidence to prove it otherwise.

The directors of Delaware Corporation owe to the corporation [1a31] and its shareholders [1a32] while performing their duties. Having said that, that does not mean that they are prohibited from taking care of the interests of other stake holders such as the society, the employees or the community in which they operate. It is suggested that in pursuing the goals of the corporate they should also mix up Environmental, Social and Governance ideas. It is immaterial whether the corporate is solvent or insolvent.

However, time and again it is confirmed that the directors owe no responsibility to the creditors [1a33] of the corporate. To reiterate from the judgement Re Trenwick Am Litig Trust, " there is no absolute obligation on the board of the company to pay its bills. Even when the company is insolvent, the board may pursue, in good faith, strategies to maximise the value of the firm."

QUESTION 4 [1a34] (fact-based application-type question) [15 marks in total]

Question 4.1 [1a35] [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?

ANSWER

The lessor will have two parties to deal with, depending on circumstances - a debtor who is his lessee and a non-debtor who is a lessee under operating lease by iWork Ltd.

iWork limited, to start with, might file a voluntary bankruptcy under Chapter 11.

In that case, under Section 365 of the Bankruptcy Code, the debtor-lessee will have the right to assume or reject the lease within 120 days from the date of confirmation order of the Chapter 11 application. ^[1a36]This can be extended by another 90 days by the bankruptcy court^[1a37]. In case the debtor-lessee is unable to have the restructuring plan approved within the 210 days then further extension can be approved by the court only if the lessor agrees to the same.

In case, the lease is assumed by the debtor-lessee, the present rental dues to the lessor upto the date of filing of Chapter 11 petition will be treated as pre-petition claim^[1a38] and paid as per provided in the restructuring plan. The rent during the time between application date and plan approval date would need to be provided for in full and cured^[1a39].

Of course the lessor can negotiate and obtain additional collateral for continuing the lease.

In case the debtor-lessee is rejecting the lease, then the lessor will be eligible to 15% of the rental due for the remainder of the lease period not exceeding three years subject to a maximum of one year's rent^[1a40]. The lessor should also be paid the rental dues upto the petition date or property re-possessed date whichever is earlier. The lessor is also eligible for legal costs as per the lease agreement as a prepetition claim.

iWork Limited might file a voluntary insolvency under Chapter 7 of the Code.

In that case, the lease contract if not assumed within 60 days from the petition date will be treated as rejected. In that case the non-debtor lessee will be seeking damages for cancellation of lease and will have lien on the property till he is satisfied. The lessor should take care of this eventuality also.

Question 4.2^[1a41] [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.

ANSWER

By virtue of having its incorporation and principal place of business in France,^[1a42] an insolvency proceedings commenced in France only will entail to be given the status of a foreign main proceedings^[1a43] as and when it files for a recognition petition under Chapter 15 of US Code.

In all the other places, the company has only 'establishments'^[1a44] to carry on their trading activities and hence insolvency cases, if and when filed in US, UK and Hongkong will be foreign non-main proceedings^[1a45] by Skin Luxe.

The US Bankruptcy Code has defined foreign proceedings as " a collective judicial or administrative proceeding in a foreign country, including interim proceeding, under a law relating to insolvency or adjustment of debt in which proceeding the assets and affairs of the debtor are subject to control and supervision by a foreign court, for the purposes of reorganisation or liquidation".

A foreign representative is the person or entity authorised in the foreign proceeding to administer the reorganisation or liquidation of the debtor's assets or affairs or to act as representative of such proceeding. On his filing a petition only a case under Chapter 15 can be commenced.

One point of contention that may arise is whether the foreign proceedings is a foreign main proceedings or a foreign non-main proceedings in a recognition petition under Chapter 15 as the nature of reliefs granted are based on that.

Question 4.3^[1a46][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 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?

ANSWER

(i) Usually in a Chapter 11 Bankruptcy case, the debtor, in order to arrange for a proper reorganisation and liquidate the liabilities before seeking vote on the plan will seek the Bankruptcy Court's approval for a section 363 sale of its unencumbered assets. As Speculation Inc is facing an investigation from DoJ^[1a47] in the method of accumulation of its assets, that is the shares acquired by them during their company's operations. Speculation Inc, though under investigation is still operated by the present management only and even would be preparing a reorganisation plan. As the creditors who have lent monies on the stocks traded, there may not be a demand for appointment of a trustee to manage the affairs of the company. In fact, being in Chapter 11, Speculation Inc will have more bargaining power in getting the plan approved and also saving themselves.

(ii) Speculation Inc can renegotiate to its favour the terms of the exiting margin loan and^[1a48] take steps to cure the existing default to continue the borrowing. The decision in Golden Seahorse case before Bankruptcy Court, New York will be helpful in how to retain the debt and continue the same under the plan. This will also help to obtain favourable voting for the reorganisation plan.

(iii) The lease has become delinquent because of the rent dues and the landlord also will be come an unsecured creditor^[1a49] and the unexpired lease will become the property of the bankruptcy estate. As Speculation Inc is seriously contemplating to be back in business and hence filed a chapter 11 petition, they would like to assume the lease. This has to happen within 120 days of filing of the petition or within 210 days if an extension is obtained from the court. In such a scenario, the rent due for the delinquent period should be provided for in full in the reorganisation plan and also all steps to cure any defect in the lease agreement should be cleared.

(iv) The employee who has filed the suit will also be an unsecured creditor and will file a claim before the court even if the employer had listed the employee's name as a creditor. She can also ask for lifting of the automatic stay for her to get a judgement before appropriate court and by that way she can make sure of her claim amount.^[1a50] Thus she can be of a nuisance value and prevent Speculation Inc from achieving a clean slate effect through the bankruptcy process. Even settlement of her claim at this stage could pose a problem of avoidable preference. It would be wise for Speculation Inc to let the matter take its own course legally.

[Type answer here]

* End of Assessment *