



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: **[student number.assessment3A]**. An example would be something along the following lines: 202021IFU-314.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 “studentnumber” 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 2021**. The assessment submission portal will close at 23:00 (11 pm) GMT on 1 March 2021. 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 2021** or by **23:00 (11 pm) BST on 31 July 2021**. If you elect to submit by 1 March 2021, you **may not** submit the assessment again by 31 July 2021 (for example, in order to achieve a higher mark).
7. Prior to being populated with your answers, this assessment consists of **8 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

FabCo, based in Utah, owes SupplyCo, based in Mexico, US\$10,000 on a past-due invoice. May SupplyCo file an involuntary petition to place FabCo into chapter 11 bankruptcy proceedings?

- (a) Yes.
- (b) Yes, if FabCo has fewer than 12 non-contingent, non-insider creditors.
- (c) Yes, if other creditors owed at least US\$5,775 join in the petition.
- (d) No, because SupplyCo doesn't know whether FabCo is insolvent.
- (e) No, because SupplyCo is not a US company.

Question 1.2

Which of the following is a *mandatory*, rather than *discretionary*, basis to deny recognition of a foreign judgment under state law based on one of the Uniform Acts?

- (a) The foreign judgment is subject to appeal in the foreign country.
- (b) The foreign judgment is an injunction.
- (c) The foreign judgment was issued by a court, contrary to the parties' agreement to arbitrate.
- (d) The defendant did not have sufficient notice of the foreign proceeding to put on a defense.
- (e) The foreign judgment is inconsistent with another final judgment on the same subject matter.

Question 1.3

Which of the following is likely to be a party in interest in the bankruptcy of XYZ Corp?

- (a) A shareholder in ABC Corp, to which XYZ Corp is substantially indebted.
- (b) A journalist writing about XYZ Corp's bankruptcy.
- (c) A shareholder in MNO Corp, which owns all of XYZ Corp's shares.

Commented [A&O1]: Total marks 30.75/50 – note plagiarism of response to 3.1

Note from Course Leader: Marks have been deducted for plagiarism. Please consult the course handbook and see instruction 5 of the assessment. No further sanction will be imposed.

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Commented [A&O3]: Incorrect, the correct response is (c)

Commented [A&O4]: Incorrect, the correct response is (b)

Commented [A&O5]: Correct, 1 mark

(d) A retired employee of XYZ Corp who receives payments from the company's pension plan.

(e) A non-profit organization that advocates for companies like XYZ Corp to be held responsible for climate change.

Question 1.4

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

- (a) The counterparty must immediately stop using the trademark.
- (b) The counterparty can continue using the trademark for the remaining period of the license.
- (c) The counterparty has a claim for damages for breach of contract.

(d) Both (a) and (c).

(e) Both (b) and (c).

Question 1.5

In which of the following circumstances may a counterparty enforce a contractual *ipso facto* clause?

(a) The contract would obligate the counterparty to extend a loan to the debtor.

(b) The contract is a lease of real property.

(c) The clause is triggered by the bankruptcy filing of a third party, not the debtor.

(d) Both (a) and (c).

(e) *Ipso facto* clauses are never enforceable against a debtor.

Question 1.6

What does a chapter 11 debtor have exclusivity to propose for the first 120 days of proceedings?

(a) Avoidance actions.

(b) A plan of reorganization.

(c) DIP financing.

(d) Lifting the automatic stay.

(e) Formation of an equity committee.

Commented [A&O6]: Incorrect, the correct response is (e)

Commented [A&O7]: Incorrect, the correct response is (d)

Commented [A&O8]: Correct, 1 mark

Question 1.7

Which of the following is **not** a requirement to confirm a “cramdown” plan?

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

Commented [A&O9]: Correct, 1 mark

Question 1.8

When may distributions to creditors diverge from the absolute priority rule?

- (a) In a chapter 7 proceeding with consent of the affected senior creditor.
- (b) In a chapter 7 proceeding with consent of the affected junior creditor.
- (c) In a chapter 11 proceeding with consent of the affected senior creditor.
- (d) In a chapter 11 proceeding with consent of the affected junior creditor.
- (e) The absolute priority rule cannot be deviated from.

Commented [A&O10]: Correct, 1 mark

Question 1.9

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 [A&O11]: Correct, 1 mark

Question 1.10

Which of the following is *not* available as relief in a chapter 15 proceeding?

- (a) Sale of US property free and clear pursuant to section 363.
- (b) Prosecution of avoidance actions pursuant to section 544 .
- (c) Entrusting the management of US assets to the foreign representative.

Commented [A&O12]: Correct, 1 mark

(d) Application of the automatic stay under section 362 to the debtor's interests in US property.

(e) Discovery about the debtor's assets.

QUESTION 2 (direct questions) [10 marks]

Commented [A&O13]: Total marks 7.25/10

Question 2.1 [maximum 1 mark]

Commented [A&O14]: Total marks 1/1

What two alternative qualifications render a corporation eligible to be a debtor in a US chapter 7 or 11 proceeding?

[A corporation is eligible to be a debtor under any chapter of the US Bankruptcy Code if the corporation's place of business is in the United States or if any of its assets are in the United States (Sec 109(a) of the Title 11)]

Commented [A&O15]: Correct, ½ mark

Commented [A&O16]: Correct, ½ mark

Question 2.2 [maximum 2 marks]

Commented [A&O17]: Total marks 2/2

What is an executory contract?

[An executory contract (defined using the "Countryman test") is one in which there are material underperformed obligations by the both the bankrupt and the other party that failure to complete performance would constitute a material breach excusing either party from performance of the other.]

Commented [A&O18]: Correct, ½ mark

Commented [A&O19]: Correct, 1 mark

Commented [A&O20]: Correct, ½ mark

Question 2.3 [maximum 2 marks]

Commented [A&O21]: Total marks 1.5/2

What is a "priming lien" and what requirements must be met for such a lien to be granted to secure DIP financing?

[A priming lien is granted by Court on estate property to secure post-petition financing. The priming lien is senior or equal to a pre-petition lien.]

Commented [A&O22]: Correct, 1 mark

In order to grant such lien the debtor must prove: (a) that the interest of the secured creditor being primed is adequately protected; (b) that any other sources of funds do not have such provisions; and (c) that substantial additional credit is being made available to the debtor.]

Commented [A&O23]: Correct, ½ mark

Commented [A&O24]: This is reversed; the debtor must show no other source of financing is available without requiring the priming lien.

Question 2.4 [maximum 2 marks]

Commented [A&O25]: Total marks 1.25/2

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 for a plan of reorganisation:

(a) An unimpaired class of creditors (including one whose acceleration of debt has been reversed is deemed to accept the plan;

Commented [A&O26]: Correct, ½ mark

(b) A class of creditors which will receive nothing is deemed to reject the plan;

Commented [A&O27]: Correct, ½ mark

(c) Only the impaired classes have the right to vote on a plan – they have the most to gain or lose.]

Commented [A&O28]: Partially correct, ¼ mark—the class must be both impaired and receiving something under the plan (whereas an impaired class that receives nothing is deemed to reject). Also, a class accepts a plan when a majority of the creditors, holding at least 2/3rds of the claims by value, vote in favor.

Question 2.5 [maximum 3 marks]

How does the automatic stay available in chapter 15 proceedings differ from that available in chapter 11 proceedings?

[The automatic stay in chapter 15 proceedings is limited only to property located in the United States]. Courts have held that chapter 15 does not create an estate, but is used by a foreign representative to obtain US recognition of foreign insolvency proceeding (see *re JSC BTA Bank No 10-10638, 2010 Bankr LEXIS 2496*).

[The automatic stay in chapter 11 is extremely broad in scope, is worldwide and comes into effect immediately on the filing of any plenary petition.]

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

Question 3.1 [maximum 3 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?

[Directors have the primary duties of care and loyalty. The duty of care requires that the directors exercise the degree of care that "ordinarily careful and prudent men would use under the circumstances". The duty of honesty requires directors to act in the best interest of the corporation and its shareholders. The duty of honesty prohibits self-dealing and abuse of corporate opportunities by directors.

In discharge of their fiduciary duties, directors have the benefit of the "business judgement rule". This rule presumes that in making business decisions, directors act on an informed basis, in good faith, and in the honest belief that the action taken is in the best interest of the corporation.

Under Delaware law, the directors' fiduciary duties lie with the solvent corporation, which is managed for the benefit of its shareholders. No fiduciary duties are owed to the creditors of a solvent corporation (see *North Am Catholic Educational Programming Foundation Inc Vs Gheewala* 930 A.2d 92, 103 (Del 2007)

The directors' duties do not change as insolvency becomes more likely. In *Gheewala* court held that "directors must continue to discharge their fiduciary duties to the corporation and its shareholders by exercising their business judgement in the best interest of the corporation for the benefit of its shareholder owners".

Once the corporation becomes insolvent the ultimate beneficiaries for whom the fiduciary duty is exercised become the creditors. However, whether solvent, potentially insolvent or actually insolvent, the duties of the directors are fundamentally the same, to pursue "value maximising strategies" for the benefit of the corporation and its residual stakeholders (see *Trenwick Am Litig Trust v Ernst & Young LLP* 906 A.2d 168 (Del Ch 2006).]

Question 3.2 [maximum 3 marks]

Describe the circumstances in which a bankruptcy court may enter a final order, who reviews appeals from bankruptcy court orders and how non-final orders are reviewed.

Commented [A&O29]: Total marks 1.5/3

Commented [A&O30]: Correct, ½ mark

Commented [A&O31]: Correct, ½ mark

Commented [A&O32]: Correct, ½ mark. In contrast, the stay comes into effect in a chapter 15 proceeding on an application for interim relief, automatically on recognition of a foreign main proceeding and discretionarily on recognition of a foreign non-main proceeding.

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Commented [A&O34]: Total marks 0/3

Commented [A&O35]: This appears to be copied from a Davis Polk publication (<https://www.dwt.com/-/media/files/publications/2008/01/the-fiduciary-duties-of-directors-of-troubled-us-c/files/the-fiduciary-duties-of-directors-of-troubled-u-s/fileattachment/the-fiduciary-duties-of-directors-of-troubled-u-s.pdf#:~:text=U.S.%20directors%20have%20the%20primary,of%20the%20corporation%20and%20its>)

Commented [A&O36]: Total marks 1.5/3

[An order is final for appeal purposes, when a decision has been entered that “ends the litigation on the merits and leaves nothing for the courts to do but to execute the judgement” (see *Coopers & Lybrand Vs Livesay* 437 U.S. 437, 467 (1978)).

A distinction is often made between “core” and “non-core” matters. Bankruptcy judges are permitted to hear and determine only core proceedings. The Statute contains a non-exhaustive list of core proceedings in Section 157(b)(2). The bankruptcy court can only make final orders on “core” matters. A bankruptcy court can only hear non-core proceedings that are sufficiently related to the bankruptcy proceedings, but cannot make a final determination on such matters. Instead the bankruptcy court proposes findings of fact and conclusions of law to the district court for a final decision.

[In *Stern Vs Marshall* 564 US 462 (2011), the Supreme Court held that even in core proceedings the bankruptcy court lacked the Article III clothing to make final decisions on bankruptcy matters].

[The Supreme Court held that bankruptcy judges may determine a core proceeding over which they lack constitutional authority by issuing a report and recommendations for review by a district court, or may with the consent of the parties issue final orders (see *Wellness Int'l Network Ltd Vs Sharif* 135 S Ct 1932 (2015)).

The Bankruptcy Rules have implemented this by requiring litigants to state in their pleadings whether they consent to the entry of final orders or judgement by the bankruptcy court, by permitting a district court that determines that a bankruptcy court did not have jurisdiction to enter a final order by treating orders by the bankruptcy court as proposed findings of fact and conclusions of law.]

Question 3.3 [maximum 4 marks]

Describe how claims for recovery of preferences, fraudulent conveyance and constructive fraudulent conveyance differ.

[A preference is a transfer of the debtor's property made in a suspect period (90 days) before the petition date. A preference must be returned to the estate if it exceeds the amount the recipient in a chapter 7 liquidation would have obtained had the transfer not been made. The avoidance of a preference is meant to equalise the treatment of similarly situated creditors and disincentivise a race to collect for a distressed debtor. Preference avoidance is aimed at transactions immediately prior to the bankruptcy (except for insider cases where the suspect period is one year)].

On the other hand, transactions within a two year period prior to the petition date may also be avoided if they constitute fraudulent conveyances (actual or constructive)].

Actual fraudulent conveyances 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”. Intent may be proven circumstantially by reference to the badges of fraud in State fraudulent transfer law (see *Ritchie Capital Management LLC vs Stoebner* 779 F.3d 857 (8th Cir 2015)).

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 the following additional factors, that: (a) the debtor was insolvent at the time of or became insolvent as a result of the transaction; (b) the debtor was unreasonably undercapitalised for the business or transaction; (c) the debtor intended to incur debts beyond its ability to pay on

Commented [A&O37]: The bankruptcy court does have authority to adjudicate challenges to petitions.

Commented [A&O38]: Correct, 1 mark. You don't address the question of who hears appeals from the bankruptcy court.

Commented [A&O39]: Correct, ½ mark

Commented [A&O40]: Total marks 3/4

Commented [A&O41]: Specifically, it must be a transfer to an existing creditor on account of an antecedent debt at a time when the debtor is insolvent.

Commented [A&O42]: Correct, ½ mark

Commented [A&O43]: Correct, ½ mark

Commented [A&O44]: Correct, 1 mark

Commented [A&O45]: Correct, ½ mark

Commented [A&O46]: Correct, ½ mark

maturity; and (d) the transfer was made to or for the benefit of an insider outside the ordinary course of business.]

Question 3.4 [maximum 5 marks]

How does a US bankruptcy court determine whether a foreign proceeding is a main or non-main proceeding under chapter 15?

[Under Chapter 15 a foreign proceeding should be recognised if: (a) the foreign proceeding is a foreign main or a foreign non-main proceeding; (b) the petition for the recognition was filed by a foreign representative; and (c) the petition satisfies certain procedural requirements. If all three criteria are met then the petition for recognition must be granted unless it is “manifestly contrary” to US public policy.

The characterisation of a foreign proceedings as *foreign main* or *foreign non-main* has important implications on the scope of relief available to the debtor following the recognition.

[A **foreign main proceeding** is a foreign proceeding pending in a country where the debtor has its centre of main interest or “COMI”. [The location of the corporate debtor’s registered office is presumed to be its COMI.] (see *re Oilinda Stars Ltd* 614 B.R. 28, 33 (bankr SDNY 2020)). In certain circumstances this presumption may be rebutted by other facts such as: (a) the location of the debtor’s headquarters; (b) the location of those who manage the debtor; (c) the location of the debtor’s primary assets; (d) the location of majority of the debtor’s creditors or a majority of the creditors that will be affected by the relief requested by the foreign representative; or (e) the jurisdiction whose law will apply to the most disputes (see *re SPhinX Ltd* 351 BR 103, 117 (Bankr SDNY 2006). A debtor’s COMI should be ascertainable by its creditors or third parties on the basis of objective evidence (see *Morning Mist Holdings Ltd Vs Krys* (In re Fairfield Sentry Ltd) 714 F.3d 127, 133-34 (2d Cir 2013)).

[A **foreign non-main proceeding** is a proceeding pending where the debtor has an establishment, which is defined as “any place of operation where the debtor carries out “non-transitory economic activity”].

In *re Bear Stearns* 374 BR 122 (Bankr SDNY 2007) court held that the Caymans Island could not be COMI for a Cayman-incorporated hedge fund because the fund was an “exempt” company, licensed on the basis that it would not have operations on the Caymans Island. The Court also found that the Cayman liquidation could not be recognised as a non-main proceeding because the debtor had had no establishment there prior to its insolvency. As a result *Bear Stearns* case, most courts will generally analyse a debtor’s COMI as at the date of filing the Chapter 15 petition and not on the commencement of the foreign proceeding. This has led to an unintended practice of manipulation of a debtor’s COMI prior to filing of chapter 15 petitions.]

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

Question 4.1 [maximum 5 marks]

Rental Corporation is a publicly-traded company that leases office space from office building owners and sublets the space to small businesses. It has recently announced that it is being investigated by the US Department of Justice Fraud Division (DOJ) regarding allegedly fraudulent misstatements of revenues; shortly after the announcement, a securities class action litigation was filed against Rental Corporation in New York federal court. Due to the increase in the numbers of businesses operating remotely, Rental Corporation has suffered a

Commented [A&O47]: Total marks 5/5

Commented [A&O48]: Correct, 1 mark

Commented [A&O49]: Correct, ½ mark

Commented [A&O50]: Correct, ½ mark

Commented [A&O51]: Correct, ½ mark

Commented [A&O52]: Correct, ½ mark

Commented [A&O53]: Correct, 1 mark

Commented [A&O54]: Correct, 1 mark

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Commented [A&O56]: Total marks 4/5

decline in revenues. As a result, it has failed to pay rent on some of its office space leases and it has just defaulted on its quarterly payment on its credit facility. What would be the effect of a chapter 11 petition being filed by Rental Corporation on each of (i) the DOJ investigation, (ii) the securities class action litigation; (iii) the delinquent leases and (iv) the credit facility?

[The filing of a chapter 11 petition immediately brings into force a worldwide automatic stay. The scope of the stay is broad and operates to prohibit any act to obtain possession or control property of the estate; the enforcement of lien against property of the estate on account of pre-petition claim; or any attempt to collect on pre-petition claims (11 USC Sec 362(a)).

Commented [A&O57]: Correct, 1 mark

As such, lessors of office space to Rental Corporation will be prohibited from taking any action on the delinquent leases. Because the automatic stay is an injunction against creditor action, the grantors of the credit facility will similar be prohibited from taking any action against the debtor during the period of the stay.

Commented [A&O58]: Correct, 1 mark

Commented [A&O59]: Correct, 1 mark

The automatic stay under the Bankruptcy Code is subject to statutory exceptions (11 USC Sec 362(b)) including criminal proceedings, regulatory investigations and exercise of rights under commodity, forward or security contract.

[Therefore the automatic stay would not affect the DOJ investigation or the securities class action litigation.]

Commented [A&O60]: Correct, 1 mark

Commented [A&O61]: Incorrect, this is a lawsuit by holders of shares in the company on claims of securities fraud and not an action to conclude a securities contract.

Commented [A&O62]: Total marks 1/5

Question 4.2 [maximum 5 marks]

Considering the facts set forth in Question 4.1, what protections does the Bankruptcy Code provide to lessors of office space to Rental Corporation?

[Prior to filing the chapter 11 petition, Rental Corporation had failed to pay rent on some of its office space leases.

Absent relief from automatic stay, the lessors may not take any action to collect, assess or recover on a claim under a commercial lease that arose before the bankruptcy case, including commencing or continuing an eviction action or attempting to collect pre-petition rent.

In connection with the bankruptcy case Rental Corporation can make one of three elections, in connection with the unexpired leases, subject to the approval of the bankruptcy court and so long as the Rental Corporation satisfies certain applicable requirements under the Bankruptcy Code. Rental Corporation can: (i) assume the lease in accordance with sections 365(a) and (b); (ii) assume and assign the lease to a third party in accordance with section 365(f); or reject the lease.

Commented [A&O63]: Rental Corporation has only 120 days to make this election, subject to one 90 day extension for cause. Any further extension requires consent of the lessor. It also must pay rent as an administrative expense for the period prior to making this election and, if it assumes and then rejects the lease, it must pay 2 years of rent as administrative expense.

The protection available to lessors once Rental Corporation has made an election to assume or assume and assign are:

- (i) to file a motion for relief from automatic stay so as to evict Rental Corporation for an uncured default before the bankruptcy case, that led to lease being expired by its terms or by operation of law;
- (ii) demand that Rental Corporation or its assignee cures the default by making payments and curing all pre-bankruptcy defaults, and also give the lessor assurance of future performance under the lease. The lessors will usually file a motion for adequate protection in these circumstances; and
- (iii) file a written proof of claim (like all other creditors) within 90 days after the first date of meeting of creditors.

Commented [A&O64]: Correct, 1 mark

Where Rental Corporation rejects the lease then the debtor is deemed to have breached the lease immediately before the petition date, giving the lessors an unsecured pre-petition claim in damages (sec 365(g)(1). Upon rejecting the lease, Rental Corporation must vacate the office space.]

Question 4.3 [maximum 5 marks]

Paint Corporation formulates house paint according to proprietary and patented recipes at its factory in the United States, which it sells to home improvement stores under a number of distribution contracts. The US Environmental Protection Agency is investigating whether Paint Corporation's operations are causing harmful chemicals to contaminate a nearby river. Paint Corporation is concerned it cannot afford the clean-up that may be required and is seeking to sell its business. Home Corporation is interested in buying the business, but does not want the potentially contaminated property (it can manufacture paint at its own factory) and is concerned about obtaining consent from all the home improvement stores to assign the distribution contracts. How would a sale under section 363 of the Bankruptcy Code address these issues?

[Pursuant to section 363 an asset may, with court approval, be sold free and clear of creditor interest. Home Corporation, as a debtor in possession, can mostly deal with its property in the ordinary course of business without court or creditor interference in a 363 sale.

A sale under section 363 can protect Paint Corporation in a number of ways:

- (a) It insulates Paint Corporation from fraudulent transfer risks that may be asserted by creditors;
- (b) Paint Corporation can select assets it wants and specifically delineate the potentially contaminated property that is the subject of EPA investigation. In this way Paint Corporation would acquire only the part of the business that it is interested in (see *Ninth Ave Remedial Group Vs Allis Chalmers Corp 195 B.R 716 (N.D. Ind 1996 on environmental claims)*);
- (c) The assets acquired by Paint Corporation will be free and clear of all liens. Paint Corporation would generally not need to worry about negotiating with secured creditors about satisfaction of their claims;
- (d) Executory contracts would generally be assigned to Paint Corporation notwithstanding any anti-assignment language in the contracts, provided outstanding defaults are cured. As such, Paint Corporation would not need to obtain consent from all the home improvement stores for the assignment of the distribution contracts.]

Commented [A&O65]: Total marks 3/5

Commented [A&O66]: Correct, 1 mark, this may generate a higher price than would be available outside of bankruptcy.

Commented [A&O67]: Correct, 1 mark, it also would be free and clear of the EPA claim and could not be overturned on appeal

Commented [A&O68]: Correct, 1 mark

*** End of Assessment ***