



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.**
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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 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

Commented [A&O1]: Total marks 37/50

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

Commented [A&O2]: Total marks 9/10

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

Commented [A&O3]: Correct, 1 mark

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

Commented [A&O4]: Correct, 1 mark

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

Commented [A&O5]: Correct, 1 mark

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.

- (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]: Correct, 1 mark

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 7.5/10

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?

ANSWER

The two alternative qualifications rendering a corporation eligible to be a debtor in a US chapter 7 or 11 proceeding are as follows:

- Presence of the debtors in the United States; or
- Presence of the place of business or any of its assets in the United States

Commented [A&O15]: Correct, ½ mark

Commented [A&O16]: Correct, ½ mark

Question 2.2 [maximum 2 marks]

Commented [A&O17]: Total marks 1.5/2

What is an executory contract?

ANSWER

An executory contract is a contract under which unperformed obligations remain on both sides or it is a situation where both parties have continuing obligations to perform at the time of the bankruptcy proceedings/petition.

Commented [A&O18]: Correct, ½ mark, and the obligations must be so substantial that if unperformed there would be a material breach

Commented [A&O19]: Correct, 1 mark

Question 2.3 [maximum 2 marks]

Commented [A&O20]: 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?

ANSWER

Priming lien refers to a situation where the seniority position of a lender with respect to a secured loan is superseded by another lender. Lenders are generally primed where the debtor is in financial distress and this affects the established priorities of existing lenders, causing old lenders (pre-petition) to lose ground relative to the Debtor in Possession (DIP) financier.

Commented [A&O21]: Correct, 1 mark, though it may also be of the same seniority as the existing lien

Requirements for securing priming lien for DIP financing:

- Debtor must demonstrate that unsecured financing cannot be obtained by it in the ordinary course of business to the bankruptcy court
- Before granting priming lien, consent from pre-petition secured lenders must be obtained
- The debtor must demonstrate that the interest of the secured creditors being primed is adequately protected as provided by u/s 361(e) of the US Bankruptcy Code
- In addition to the above, DIP financier will require super priority claim status above all other claims

Commented [A&O22]: Correct, ½ mark

Commented [A&O23]: Incorrect, their consent is unnecessary if the court finds they are adequately protected, deducting ½ mark

Commented [A&O24]: Correct, ½ mark

Question 2.4 [maximum 2 marks]

Commented [A&O25]: Total marks 1.5/2

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?

ANSWER

- (i) Deemed to accept the plan – Unimpaired class of creditors
- (ii) Deemed to reject the plan and – A class that receives nothing or is the impaired class of creditors
- (iii) Permitted to vote on the plan – Impaired class of creditors

Vote is necessary for a class of creditors to accept a plan:

Under section 1126(c) and (d) of the US Bankruptcy Code, a given class of creditors approves the plan by a simple majority of the creditors in the class holding at least two thirds of the value of claims in the class vote in favour or, for equity interests, if two thirds in amount of interests vote in favour.

Question 2.5 [maximum 3 marks]

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

ANSWER

Automatic stay under chapter 11 is effective on filing of a bankruptcy petition whereas the filing of petition under chapter 15 does not invoke automatically stay of creditor action. The stay arises only upon the petition for recognition of a main proceeding being granted. The automatic stay in a chapter 15 proceeding is subject to a carve-out to permit the filing of plenary US bankruptcy proceeding even after the recognition of a foreign proceeding.

Stay under chapter 11 is a worldwide automatic stay on proceeding against debtor or his assets whereas stay under chapter 15 is to protect the debtor's assets within the territorial jurisdiction of United States. Hence, the automatic stay under chapter 11 cases with its global reach does not share the jurisdictional model of the chapter 15 cases as seen in JSC BTA Bank case.

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?

ANSWER

Duty of loyalty to the corporation's best interests and a duty of care in educated decision-making are the fiduciary duties owed by directors of Delaware corporations in the ordinary course of business.

The general rule is that directors do not owe creditors duties beyond their relevant contractual terms. The Delaware Supreme Court (*North American Catholic Education Programming Foundation, Inc vs Gheewala*) stated that in case of potential or actual insolvency, basic

Commented [A&O26]: Correct, ½ mark

Commented [A&O27]: Partially correct, ½ mark, a class that takes nothing is deemed to reject but not all impaired classes are deemed to reject as impaired creditors that receive something under the plan are permitted to vote

Commented [A&O28]: Correct, ½ mark

Commented [A&O29]: Total marks 2/3

Commented [A&O30]: Correct, ½ mark

Commented [A&O31]: Correct, ½ mark, or it may come into effect on an application for interim relief or as discretionary relief on recognition of a foreign non-main proceeding

Commented [A&O32]: Correct, ½ mark

Commented [A&O33]: Correct, ½ mark

Commented [A&O34]: Total marks 12.5/15

Commented [A&O35]: Total marks 2.5/3

Commented [A&O36]: Correct, ½ mark

Commented [A&O37]: Correct, ½ mark

Commented [A&O38]: Incorrect, the contractual terms bind the corporation and not the directors personally.

Commented [A&O39]: Correct, ½ mark

fiduciary duties of Delaware directors continue to be owed to their corporation's best interest and to the shareholders.

Commented [A&O40]: Correct, ½ mark

Commented [A&O41]: Correct, ½ mark

Question 3.2 [maximum 3 marks]

Commented [A&O42]: Total marks 2.5/3

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.

ANSWER

Since bankruptcy court has limited jurisdiction, the judge can enter a final order in core matters only. The Bankruptcy Code contains a non-exhaustive list of core proceedings. If the case is a non-core issue then the bankruptcy court may hear the matter if it is related to the bankruptcy but enter into final judgement only if the parties consent, else the bankruptcy judge can hear the matter and submit a report called the findings of facts and conclusions of law for consideration of the district court judge or the non-core matter can be heard directly by the district court. A final order closing the case is entered into after the estate is has been fully administered. Local bankruptcy policies generally determine when the final order is entered and the case is closed.

Commented [A&O43]: Partially correct, ½ mark, the bankruptcy court can adjudicate a challenge to a petition or a core matter with the consent of the parties

Commented [A&O44]: Correct, 1 mark

Appeals against the orders of the bankruptcy court are reviewed by the Bankruptcy Appellate Panel (BAP) or the district court after which only specific or filtered appeals or refined arguments are heard by the circuit court of appeals. In rare circumstances, an appeal from the bankruptcy court may go directly to the court of appeals, where the bankruptcy court or district court certified that (i) where an appeal raises a question of law and there is no controlling decision of the circuit court or the US Supreme Court or requires resolving conflicting controlling decision or (ii) immediate appeal may materially advance progress of the case.

Commented [A&O45]: Correct, ½ mark

Commented [A&O46]: Correct, ½ mark

Under 28 U.S.C section 158 – Appeals, non-final or interlocutory orders may be appealed only with the leave of the appellate court (district court or BAP).

Question 3.3 [maximum 4 marks]

Commented [A&O47]: Total marks 3.5/4

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

ANSWER

Difference in claims for recovery of preferences, fraudulent conveyance and constructive fraudulent conveyance transactions:

Key Differentiating Factor	Preferences	Fraudulent Conveyance	Constructive Fraudulent Conveyance
Intent of the transaction	Transaction of transfer made to or for the benefit of the creditors.	Transaction undertaken with the intention to prevent creditors from having access to assets to satisfy their claims or to hinder, delay the insolvency process.	Transaction undertaken at undervalue with an insider with the intention to prevent creditors from having access to assets to satisfy their claims

Commented [A&O48]: Correct, ½ mark

Commented [A&O49]: Correct, ½ mark

Commented [A&O50]: Incorrect, -1/2 mark, a constructive fraudulent transfer can occur without any intent to deprive creditors and can be with a non-insider

Key Differentiating Factor	Preferences	Fraudulent Conveyance	Constructive Fraudulent Conveyance
Look back period/Suspect period for determining the claim	Non-insiders – 90 days prior to the bankruptcy petition date. Insiders – one year prior to the bankruptcy petition date.	Generally, 2 years prior to the bankruptcy petition date. However, the debtor in possession or trustee may invoke longer look back periods under state and foreign fraudulent laws.	
Claim transaction coverage net	Largely aimed at covering transactions with financial and operating creditors.	Largely aimed at covering transactions with insiders or related parties.	
Antecedent debt	Trustee must prove that the alleged preferential transaction was made on account of antecedent debt.	For the debtor to enter into a fraudulent conveyance there is no pre-requisite for an antecedent debt.	
Retention of property or enforcement of obligations	The creditors are not penalized for the action, however the transaction is annulled and the property has to be returned and status quo ante is maintained	Bonafide purchaser is exempt - retention allowed in good faith for arm's length transactions except where the transaction is voidable or at an undervalue or for inadequate consideration.	
Defenses against claims made	Number of defenses and safe harbors available for creditors to keep pre-petition transfer that have occurred in the suspect period.	Trustee will need to show circumstantial evidence demonstrating fraudulent intent behind the transfers. Intent for actual fraudulent conveyance may be proven circumstantially by the trustee, by reference to the "badges of fraud" developed under the state fraudulent transfer laws.	

Commented [A&O51]: Correct, ½ mark

Commented [A&O53]: Correct, 1 mark

Commented [A&O52]: Correct, ½ mark, also note that in either case the transaction must have been made while the debtor was insolvent

Commented [A&O54]: Incorrect, as noted above this can occur with unrelated parties—e.g., a subsidiary's guarantee of its parent's obligations may be a constructive fraudulent conveyance if the subsidiary does not receive sufficient value from the transaction

Commented [A&O56]: Correct, ½ mark

Commented [A&O55]: Correct, ½ mark

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?

ANSWER

Chapter 15 and the UNCITRAL model law (MLCBI) outline how a foreign proceeding can be recognized by a US bankruptcy court. A Chapter 15 case can only be commenced on the bankruptcy court recognizing a foreign insolvency proceeding on filing of a petition by a foreign representative of the debtor in the foreign insolvency proceeding. The debtor in a foreign insolvency proceeding is not entitled to any relief, including automatic stay, until the bankruptcy court actually recognizes the proceedings.

Commented [A&O57]: Total marks 4/5

Foreign main proceedings are commenced at the debtor's Centre Of Main Interest (COMI) and foreign non-main proceedings are commenced at the place where the debtor has an establishment. As per UNCITRAL Guide to Enactment and Interpretation, both COMI and establishment is reckoned from the date of commencement of the foreign proceeding. The US Bankruptcy law typically uses concepts of domicile, principal place of business and location of assets to determine jurisdiction and venue. Concepts of COMI and establishment are imported into US Bankruptcy Code from the European Insolvency Regulations via the UNCITRAL MLCBI. Hence the US Bankruptcy Courts will determine whether a foreign proceeding is a main or non-main proceeding basis debtor's COMI. Under 11 USC Code section 1516(c), debtor's COMI is presumed to be in the country of the debtor's registered office, however, this presumption is rebuttable.

Commented [A&O58]: Correct, 1 mark

Commented [A&O59]: Correct, 1 mark

Commented [A&O60]: But in the US, this is generally assessed as of the date of the commencement of the US proceeding

Commented [A&O61]: Correct, ½ mark

A debtor's COMI can be determined basis the following factors:

- Location of headquarters
- Location of management
- Location of primary assets
- Location of majority of debtor's creditors or majority of creditors who will be affected by the relief requested
- Jurisdiction whose law will apply to most disputes

Commented [A&O62]: Correct, 1 mark

COMI should be ascertainable by debtor's creditors or third parties on the basis of objective evidence.

Commented [A&O63]: Correct, ½ mark

Proceedings in jurisdiction other than debtor's COMI can be recognized as a foreign non-main proceedings only if the debtor has an establishment in that jurisdiction.

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

Commented [A&O64]: Total marks 8/15

Question 4.1 [maximum 5 marks]

Commented [A&O65]: Total marks 4/5

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 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?

ANSWER

Once chapter 11 petition is filed by a debtor, a worldwide automatic stay comes into effect providing breathing space to the debtor to re-organise his business through a properly formulated restructuring plan, negotiate with creditors and sell assets in an orderly manner, for the process culminating into settlement of creditors in accordance to the priorities set out in the Bankruptcy Code. The automatic stay under chapter 11 is intended to prohibit actions related recovery of debt against the assets of the debtor. Any proceedings that do not result in endangering, diminishing, dissipating or adversely impacting the assets of the debtor are not prohibited.

Commented [A&O66]: Correct, 1 mark

Effect of a chapter 11 petition being filed by Rental Corporation on

(i) the DOJ investigation – The DOJ investigation for alleged frauds is a regulatory investigation is subject to a statutory exception hence it can continue against the debtor.

Commented [A&O67]: Correct, 1 mark

(ii) the securities class action litigation – securities class action suits for fraudulent mis-statements are not stayed and can continue against the directors and officers of the company.

Commented [A&O68]: Incorrect, this is a pre-petition litigation against the debtor and therefore would be stayed

(iii) the delinquent leases – a automatic stay under chapter 11 prevents the landlord from taking any action to collect, assess or recover a claim against the debtor that arose before commencement of the bankruptcy petition, the stay further prevents the landlord from commencing eviction actions or continuing unfinished evictions. Landlord would need to file a claim as unsecured creditor for the pre-petition dues.

Commented [A&O69]: Correct, 1 mark

A tenant must prove that it can meet all future payment obligations, he must provide adequate assurance of future performance under the lease which may be demonstrated through cash flow sufficiency or grant additional security in the restructuring plan as outlined in 11 USC section 361 and section 365(b)(1).

(iv) the credit facility – Automatic stay on a credit facility under chapter 11 covers payment of principal as well as interest. The financial creditor will need to file a claim as a secured creditor where facility is secured or as unsecured creditor. No payments are released by the debtor to the financial creditors during the moratorium period. Unsecured creditors will need to be a part of committee of creditors to negotiate with the debtor to formulate an acceptable restructuring plan.

Commented [A&O70]: Correct, 1 mark

Question 4.2 [maximum 5 marks]

Commented [A&O71]: Total marks 1/5

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

ANSWER

Lessors of office space can continue to receive rent in the period of the automatic stay and Rental Corp is required to pay the post-petition rents and keep those rent payment current as long as the premises is occupied. Accrued rents are considered as administrative expense receiving preference over other debts. Rental Corp must prove that it can meet all future payment obligations and must provide adequate assurance of future performance under the lease as outlined in 11 USC section 361 and section 365(b)(1).

Commented [A&O72]: Note that Rental Corporation only has 120 days to decide whether to assume or reject the leases. This period can be extended by 90 days for cause, but not further without lessor consent

Commented [A&O73]: Correct, 1 mark

Commented [A&O74]: Only if Rental Corp is assuming the leases

Alternatively, lessors can request the bankruptcy court to lift the automatic stay provided they are able to prove that they will suffer irreparable damage if the stay isn't lifted.

Since lessors take rental/security deposits they are secured creditors must file a claim under the claims process with the claims manager and can proceed to recover due from guarantors/sureties in case of shortfall in rent collection since there is no stay on recoveries from guarantors.

Commented [A&O75]: They will be secured creditors only to the extent of the security deposit; they will likely have an unsecured claim for some portion of the unpaid pre-petition rent. They will also have an administrative priority claim for 2 years rent if the debtor assumes and then rejects a lease.

Since the lessor is a secured creditor, Rental Corp may move to classify rental payments in suspect period as preferential transaction however the landlord can contest this claim, firstly, showing that payments received were in the ordinary course of business between Rental Corp and landlord; secondly landlord can show that the rental payments in suspect period were made according to ordinary business terms/customary business practice between them.

Question 4.3 [maximum 5 marks]

Commented [A&O76]: Total marks 3/5

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?

ANSWER

Section 363 of the US Bankruptcy Code permits a debtor to sell assets free and clear of claims, lien and interest outside of the Chapter 11 restructuring plan. Section 363 sale offers the purchaser an opportunity to acquire clean title to the assets. The process for sale under section 363 is relatively simple and shorter than the sales under a chapter 11 restructuring plan. The sale is mostly on a going concern basis based on sound business judgement demonstrated by the debtor in possession.

In the instant case, Home Corporation is interested in buying the business of Paint Corp. Acquisition envisaged in this case is limited to the proprietary and patented recipes (formulations) and distribution contracts. For the purpose of a sale under section 363, Home Corporation is the stalking horse since the company has evinced interest in the business acquisition of Paint Corporation.

Some of the benefits for acquisition under section 363 in the instant case are as follows:

- Simple shorter process
- Acquisition of intangible assets free and clear of liens
- Sanctioned by the bankruptcy court
- Ability to cherry pick assets
- Flexibility in assuming executory contracts

Concerns addressed under section 363 sales:

- Obtaining consent from all the home improvement stores to assign the distribution contracts

Flexibility in assuming executory contracts

Section 365 of the US Bankruptcy Code permits the debtor viz, Paint Corporation to assume and assign executory contracts as it deem fit providing buyer enhanced leverage while dealing with contact counter parties, who may agree to compromise in order to avoid having their contracts rejected.

- US Environmental Protection Agency is investigating whether Paint Corporation's operations are causing harmful chemicals to contaminate a nearby river

Section 363 does not specifically deal with environmental liabilities or toxic torts or successor liabilities. Since the sale envisaged above is of the formulations business and distribution contracts and not the contaminated land and building, no liability would devolve upon Home Corporation since they would get the title to the intangibles free from any claims, liens or encumbrances and Paint Corporation would continue to be liable to perform clean-up action recommended by the US Environmental Protection Agency from the proceeds of sale or the federal or state agency may perform the necessary clean-up

Commented [A&O77]: Correct, 1 mark, also note that the purchaser would have the certainty that the sale could not be overturned on appeal

Commented [A&O78]: Correct, 1 mark

Commented [A&O79]: Correct, 1 mark, also this may result in a higher sales price for the assets

activity and charge Paint Corporation for the clean-up since such obligations survive bankruptcy.

*** End of Assessment ***