SUMMATIVE (FORMAL) ASSESSMENT: MODULE 3A

THE INSOLVENCY SYSTEM OF THE UNITED STATES

This is the **summative (formal) assessment** for **Module 3A** of this course and is compulsory for all candidates who **selected this module as one of their compulsory modules from Module 3**. Please read instruction 6.1 on the next page very carefully.

If you selected this module as **one of your elective modules**, please read instruction 6.2 on the next page very carefully.

The mark awarded for this assessment will determine your final mark for Module 3A. In order to pass this module, you need to obtain a mark of 50% or more for this assessment.

INSTRUCTIONS FOR COMPLETION AND SUBMISSION OF ASSESSMENT

Please read the following instructions very carefully before submitting / uploading your assessment on the Foundation Certificate web pages.

1. You must use this document for the answering of the assessment for this module. The answers to each question must be completed using this document with the answers populated under each question.

2. All assessments must be submitted electronically in MS Word format, using a standard A4 size page and a 11-point Arial font. This document has been set up with these parameters – **please do not change the document settings in any way**. **DO NOT** submit your assessment in PDF format as it will be returned to you unmarked.

3. No limit has been set for the length of your answers to the questions. However, please be guided by the mark allocation for each question. More often than not, one fact / statement will earn one mark (unless it is obvious from the question that this is not the case).

4. You must save this document using the following format: **[studentID.assessment3A]**. An example would be something along the following lines: 202122-514.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 "studentID" 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 2022**. The assessment submission portal will close at 23:00 (11 pm) GMT on 1 March 2022. 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 2022** or by **23:00 (11 pm) BST (GMT +1) on 31 July 2022**. If you elect to submit by 1 March 2022, you **may not** submit the assessment again by 31 July 2022 (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

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

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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

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ABC Corp is filing for bankruptcy under chapter 11. Which of the following **is not** a party in interest in that proceeding?

(a) A neighboring land owner who has leased equipment to ABC Corp.

(b) ABC's government regulator.

(c) A bank that has loaned money to ABC.

(d) A local advocacy group.

(e) All of the above.

Question 1.2

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Which of the following statements regarding executory contracts is **false**?

(a) Executory contracts are clearly defined by the bankruptcy code.

(b) Chapter 11 debtors have greater flexibility than chapter 7 debtors on when they may assume, assign or reject an executory contract.

(c) In the most common formulation, executory contracts are defined as those where both sides to a contract have material unperformed obligations.

(d) A court will generally defer to a debtor's business judgment regarding whether to assume 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 1.3

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In which of the following scenarios does a bankruptcy court have constitutional authority to issue a final order? Assume in each that the counterparty to the dispute has not consented to the bankruptcy court's exercise of jurisdiction.

(a) A counterclaim against the estate that introduces a question under state law.

(b) Since the list of core proceedings is non-exhaustive, a bankruptcy court may issue a final determination on any matter that comes before it.

(c) A creditor's claim against an affiliate of the debtor that has guaranteed the debtor's obligation to the creditor

(d) A debtor's motion to dismiss an involuntary bankruptcy petition.

(e) None of the above.

Question 1.4

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

(a) A pre-pack cannot be used if the debtor wishes to reject executory contracts.

(b) Creditors must have sufficient information about the debtor and the plan to make an informed voting decision.

(c) A pre-pack debtor may spend as little as a single day in bankruptcy.

(d) The proposed plan of reorganization is submitted to the bankruptcy court together with the voluntary petition.

(e) Creditors' commitment to vote in favor of the plan may be memorialized in a restructuring support agreement.

Question 1.5

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Which of the following statements regarding cramdowns is **true**?

(a) If one insider creditor approves of the plan of reorganization, all other impaired classes may be crammed down.

(b) Because cramdowns do not require the consent of all classes, the plan of reorganization may not be fair and equitable to all impaired classes.

(c) Differential treatment of different classes is permitted if there is a reasonable, good faith basis for doing so and such treatment is required for the plan of reorganization to be successful.

(d) Class definition is rarely a battleground when a debtor tries to cramdown classes.

(e) Dissenting creditors are not permitted to challenge the classification of a creditor supporting the cramdown.

Question 1.6

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Which of the following statements about the plan exclusivity period is **true**?

(a) The exclusivity period is 1 year.

(b) The exclusivity period cannot be extended.

(c) The exclusivity period cannot be shortened.

(d) During the exclusivity period, only a creditor may propose a plan of reorganization.

(e) During the exclusivity period, only the debtor may propose a plan of reorganization.

Question 1.7

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Which of the following statements about chapter 15 is **false**?

(a) The automatic stay applies upon the filing of a petition for recognition.

(b) A debtor cannot be subject to an involuntary chapter 15 proceeding.

(c) A chapter 15 petition must be filed by a foreign representative.

(d) The automatic stay applies only to property within the territorial jurisdiction of the United States.

(e) Recognition may be granted to a foreign proceeding as either foreign main or foreign non-main.

Question 1.8

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Which of the following statements about 363 sales is **false**?

(a) A 363 sale permits a debtor to sell an asset free and clear of encumbrances.

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

(c) A 363 sale must be conducted as an auction with a stalking horse bidder.

(d) Purchasers may pay a higher price for assets sold in a 363 sale than in an out-of-court transaction.

(e) Sophisticated parties will insist on a 363 sale if there is any question regarding whether the sale is "in the ordinary course of business".

Question 1.9

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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 has a claim for damages for breach of contract.

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

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

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

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

Question 1.10

Who may serve as a foreign representative to seek recognition of a foreign proceeding under chapter 15?

(a) The board of directors of the debtor if it is a debtor-in-possession in the foreign proceeding.

(b) An insolvency professional appointed by a creditor where the foreign proceeding is an involuntary receivership.

(c) An officer of the debtor if it is a debtor-in-possession in the foreign proceeding.

(d) An insolvency professional appointed by the court overseeing the foreign proceeding.

(e) All of the above.

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QUESTION 2 (direct questions) [10 marks]

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Question 2.1 (2 marks)

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What is the difference between a voluntary petition for bankruptcy and an involuntary petition for bankruptcy?

1. A voluntary petition does not require alleging a state of insolvency. Therefore, although the petition form requires the debtor to disclose an estimate of available funds, number of creditors, assets and liabilities, it is not necessary that the debtor be insolvent or claim to be insolvent. In turn, the involuntary petition form does require petitioning creditors to allege that the debtor is not paying its debts when due, for a reason other than that there is a dispute as to liability or amount or that, "*within 120 days prior to the filing of this petition, a custodian, other than a trustee, receiver or agent appointed or authorized to take charge of less than all of the debtor's property for the purpose of foreclosing a lien on such property, was appointed or took possession of the property*"

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2. A debtor may commence a voluntary proceeding by filing a petition. This petition is sufficient to invoke the automatic stay. Unless the petition is challenged, the court will not enter any further court order with respect to the existence of the case and the automatic stay. Involuntary petitions are also immediately effective to invoke the automatic stay, but they require the court to issue an order confirming the petition.

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3. Finally, the creditors may commence an involuntary proceeding under either chapter 7 or chapter 11. Involuntary proceedings cannot be commenced under the other chapters or against a farmer, family farmer or not-for-profit corporation. The number of petitioning creditors required depends on how many non-contingent, non-insider creditors the debtor has — if it has fewer than 12 such creditors, only one is required to file an involuntary petition; if it has 12 or more such creditors, at least three qualifying creditors must join in the petition. In turn, a debtor may initiate a voluntary proceeding under any chapter of the Bankruptcy Code.

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Question 2.2 (2 marks)

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

The violation of the automatic stay may generate the following consequences:

1. The act is void or voidable: An act performed in violation of the stay constitutes contempt of court and is void or voidable depending on the circuit in which the bankruptcy is pending. However, interested parties may apply to lift the stay prospectively to retroactively permit or validate an act that would otherwise constitute a violation of the stay.

2. Contempt fines: if the suspension is not lifted, contempt sanctions may be imposed on the violator of the suspension. Such penalties may include payment of the debtor´s attorneys´ fees and a requirement that the violator perform affirmative acts to undo the effect of its violation. In this regard, it is important to note that the U.S. Supreme Court has recently stated that the stay only prohibits affirmative acts that change the status quo of the state´s property.

These consequences apply even if done without notice of the filing of the petition.

Question 2.3 (3 marks)

In what circumstances is a claim considered "impaired"? When is a holder of an impaired claim not entitled to vote on a proposed plan of reorganization and what happens instead?

A class is impaired when the plan alters the holder's "legal, equitable and contractual rights", i.e., the holder receives less than 100% of its claims. However, a class may be considered unimpaired when the plan reverses the contractual acceleration by curing any monetary default and compensating the holder for any damages. Delay in full payment (after the effective date of the plan) is considered an impairment.

Only the impaired classes are entitled to vote on the plan.

However, there is a figure whereby a holder of an impaired claim is not entitled to vote on a proposed plan of reorganization, which is called a "cramdown." Under this figure, the reorganization plan can be confirmed by the court without the approval of all classes of impaired creditors, but only by a class of such creditors.

To qualify for cramdown, the plan must be approved by at least one class of impaired creditors and make the impaired class no worse off than it would be in chapter 7 liquidation.

Thus, in order to use cramdown, all other requirements for confirmation of the reorganization agreement must be met and at least one impaired class (excluding insiders) must have voted to accept the plan. In any event, in order to be confirmed, the plan must not "unfairly discriminate" and must be "fair and equitable" to the non-consenting aggrieved groups.

Question 2.4 (3 marks)

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

(1) Which cause of action applies only to transfers made on account of antecedent debt?

The requirement "*For or on account of a prior debt incurred by the debtor before such transfer was made*" is relevant in determining whether a claim is a preference or not.

First, a preference is a transfer of the debtor's assets made within a suspect period prior to the date of the petition, which must be returned to the estate if it exceeds the amount that the beneficiary would have received in a chapter 7 liquidation had the transfer not taken place.

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Commented [H(23]: Partially correct, 1/2 mark. Holders of impaired claims that will receive nothing cannot vote, whether or not a cramdown is being employed. The creditors receiving nothing are deemed to reject the plan.

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Under this figure, it is not necessary to prove any fault on the part of the debtor or the transferee in connection with the payment made, and that the transferee creditor suffers no penalty other than the return of the transfer.

One of the elements to establish whether a claim is preference is that it was given "*for or on account of a prior debt incurred by the debtor before such transfer was made*". This requirement requires showing that the debtor pays a creditor for a pre-existing debt.

In determining the above, the Bankruptcy Code looks to applicable non-bankruptcy law to define when a debt arose and when a transfer of an interest in the debtor's property occurred.

Thus, for example: the date of the transfer, in the case of a security interest, is the date of perfection of the security interest if perfection occurred more than 30 days after the transfer became effective between the parties. If a security interest is not perfected before the request date, the automatic stay will prevent the security interest from being perfected and the security interest will be unenforceable.

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

The requirement is relevant to determine whether a claim is preferential or not. This is because one of the elements of a preference claim is "*Made while the debtor was insolvent*".

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Thus, it is presumed that the debtor was insolvent within 90 days prior to the date of the petition, for purposes of determining preference claims. A creditor may present evidence to rebut the presumption, and the burden of proving insolvency based on the balance sheet at the time of transfer ultimately rests with the trustee or debtor.

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

The avoidance of preferences is directed to transactions immediately preceding the bankruptcy. However, other transactions made within a period of two years prior to the petition date may also be annulled if they constitute fraudulent conveyances. To do so, it must be shown 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.*"

Commented [H(27]: Correct, 1 mark--actual fraudulent conveyances

Intent can be proven through the following "badges of fraud":

1. "*The transfer or obligation was to an insider;*
2. *The debtor retained possession or control of the property transferred after the transfer;*
3. *The transfer or obligation was disclosed or concealed;*
4. *Before the transfer was made or obligation was incurred, the debtor had been sued or threatened with suit;*
5. *The transfer was of substantially all the debtor's assets;*
6. *The debtor absconded;*
7. *The debtor removed or concealed assets;*
8. *The value of the consideration received by the debtor was not reasonably equivalent to the value of the asset transferred or the amount of the obligation incurred;*
9. *The debtor was insolvent or became insolvent shortly after the transfer was made or the obligation was incurred;*
10. *The transfer occurred shortly before or shortly after a substantial debt was incurred; and*

11. *The debtor transferred the essential assets of the business to a lienor that transferred the assets to an insider of the debtor*"

In this regard, it should be noted that there are transactions that can be annulled without the need to prove fraudulent intent, such transactions are called "constructive fraudulent conveyances".

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

Question 3.1 (3 marks)

How did *Stern v Marshall* change the law of bankruptcy court jurisdiction and authority to enter a final order?

The case of Stern v Marshall modified the jurisdiction of the bankruptcy courts to resolve the issues presented in the core proceedings.

Prior to this ruling, and by virtue of the amendments to the Bankruptcy Code of 1984, such jurisdiction was well established. In this regard, (i) the statute established a distinction between "core" and "non-core" proceedings, and (ii) stated that bankruptcy judges could hear and resolve only core proceedings. To this end, the statute included a non-exhaustive list of core proceedings.

With respect to non-core proceedings, the statute provided that the bankruptcy court could hear non-core proceedings if they are sufficiently related to a bankruptcy proceeding. However, its jurisdiction was limited in that while the bankruptcy court could hear the proceeding it could not make a final decision. Instead, the bankruptcy court submitted findings of fact and conclusions to the district court, for the district court to make the final decision.

This delineation of the bankruptcy court's jurisdiction changed in 2011, with the Stern v Marshall case, in which the U.S. Supreme Court noted that even in core proceedings, a bankruptcy court cannot issue final orders. This is because it encroaches on Article III jurisdiction.

In the "Stern v Marshall" case, a bankruptcy claim had been filed against the debtor and the debtor filed a counterclaim. At the same time, the counterclaim issues were the subject of a separate state court proceeding.

The bankruptcy court entered its ruling first, awarding $400 million to the debtor, but the state court case continued while the bankruptcy judgment was being appealed to the district court. The state court decided in favour of the plaintiff prior to the district court's judgment affirming the bankruptcy court's judgment.

In this regard 28 U.S.C. § 157 provides that a counterclaim is a basic proceeding upon which a bankruptcy court may issue a final order, however the United States Supreme Court held that the bankruptcy court's issuance of a final order on a state law claim was unconstitutional under Article III. Therefore, the jury's decision was the first final judgment and was conclusive on the issues.

Since that ruling, the U.S. Supreme Court and amendments to the Bankruptcy Rules have led to the conclusion that (i) district courts have exclusive jurisdiction to adjudicate a petition initiating a bankruptcy proceeding, and (ii) a bankruptcy court may exercise a district court's delegated authority to enter a final order on a motion challenging the validity of a petition.

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The U.S. Supreme Court has held that litigants may choose the following two alternatives: i) resolve a core proceeding over which they lack constitutional authority by issuing a report and recommendation for review by the district court (the same procedure as in non-core proceedings) or, ii) with the consent of the parties, they may issue final orders.

Question 3.2 (3 marks)

What provisions of the Bankruptcy Code may not be invoked by a foreign representative in a chapter 15 proceeding? What are two ways that the foreign representative can obtain equivalent relief?

Chapter 15 excludes from the rights granted to foreign representatives the use of the avoidance powers provided for in the Bankruptcy Code. However, there are the following two ways in which the foreign representative can obtain equivalent relief:

1. The foreign representative may seek to avoid pre-bankruptcy transactions under other applicable U.S. or foreign laws. This is because the limitation only applies to the use of the Bankruptcy Code's preference avoidance and fraudulent conveyance powers.

2. The foreign representative may invoke the avoidance powers of the Bankruptcy Code in a plenary proceeding such as Chapter 7 or 11. In these circumstances, the scope of the plenary proceeding is limited to the U.S. assets of the debtor and will be coordinated with the foreign proceeding. Thus, a foreign representative may wish to initiate a plenary proceeding to obtain access to the avoidance powers of the Bankruptcy Code when relief under other applicable law is not satisfactory, such as when the statute of limitations has expired or the applicable law does not allow constructive fraudulent conveyance claims..

Question 3.3 (4 marks)

Describe the differences between interlocutory and final orders and how an appeal may be taken from each. Which courts hear direct appeals from bankruptcy court orders?

The U.S. bankruptcy procedure distinguishes between final orders and interlocutory orders, as follow:

1. Final orders: Final orders are those that resolve all issues, leaving nothing further to be decided. These final orders may be appealed as of right. However, orders extending the exclusivity period for proposing a plan are subject to appeal as of right.

2. Interlocutory orders: Interlocutory orders only resolve certain issues or claims and can only be appealed with leave of the appellate court.

In general, appeals from bankruptcy court decisions are heard by the district court in which they are located. However, in some circuits, bankruptcy appeals are decided by a Bankruptcy Appellate Panel (BAP). Such a panel is convened by the judges of the bankruptcy courts within the circuit. In those circuits, a party has the option of requesting that the appeal be heard by the district court instead.

From the district court or the BAP, there is a subsequent appeal as of right to the circuit appellate court.

It is unusual for an appeal from a bankruptcy court to go directly to the court of appeals, where the bankruptcy court or district court certifies that (i) the appeal raises a question of law on which there is no controlling decision of the circuit or U.S. Supreme Court, or requires resolving conflicting controlling decisions, or (ii) the instant appeal may materially advance the progress

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of the case. The appellate court has the discretion to decide whether to accept a case so certified.

Question 3.4 (5 marks)

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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?

1. Fiduciary Duties of Directors of Delaware Corporations

The liability of directors is governed by the law of the state of incorporation. In Delaware, directors owe a fiduciary duty of loyalty to the corporate interest and a duty of care in making educated decisions. However, their actions are protected from liability for errors of judgment by the business judgment rule.

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Under the business judgment rule, the board of directors is presumed to have acted in good faith and to have made its decisions based on reasonable information. However, this presumption may be rebutted. Unless the presumption is rebutted, directors will not be liable absent a showing of gross negligence.

The business judgment rule can be rebutted by showing that the majority of the board i) was not reasonably informed, ii) did not honestly believe that its decision was in the best interest of the corporation, iii) or was not acting in good faith.

Also, the actions of the directors may be protected as provided in the corporation's certificate of incorporation. This certificate may exempt the directors from liability for breach of the duty of care. However, directors cannot be exempted from liability for breach of the duty of loyalty.

On the other hand, the business judgment rule does not apply when a transaction is approved by a majority of the board that is not independent or when a majority shareholder is on both sides of the transaction. In such circumstances, the transaction will be void unless the entire fairness standard is met.

2. To whom duties are owed in the ordinary course of business?

The duties of directors are owed to the corporation and its shareholders.

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3. To whom duties are owed when the company is potentially or actually insolvent?

As in the ordinary course of business, directors' duties are owed to the corporation and its shareholders, not to creditors. In this regard, the Delaware Supreme Court has noted that directors do not owe duties to creditors when a corporation is operating "in the zone of insolvency," or is in fact insolvent, but to the corporation and its shareholders".

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

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Question 4.1 [4 marks]

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Gambling Corporation is incorporated and has a principal place of business in Greece and it operates casinos and betting parlors in many international cities, including Athens, Las Vegas, London and Macau. Gambling Corp's bonds (governed by English law) are due to mature in one (1) year, but it is unable to repay or refinance them. Gambling Corp 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.

1. A foreign proceeding is defined by the Bankruptcy Code as "a collective judicial or administrative proceeding in a foreign country . . . under a law relating to insolvency or adjustment of debt in which proceeding the assets and affairs of the debtor are subject to control or supervision by a foreign court, for the purpose of reorganization or liquidation."

2. The following requirements that must be met for a process to be considered a foreign process can be extracted from this definition:
   a. Judicial or administrative proceeding
   b. Collective proceeding
   c. In a foreign state
   d. Law relating to insolvency
   e. A process in which the debtor's assets are subject to the control or supervision of a foreign court.

3. According to the information in the case, Gambling Corp. will initiate an English scheme of arrangement to restructure bonds owned by it that are governed by English law.

4. From such information it is not possible to determine whether such scheme complies with each of the above points, as indicated below:

   a. It cannot be established whether such restructuring scheme, is a private one between the company and the holders of such bonds, or whether it is a judicial or administrative process.

   b. It cannot be determined whether this would be a collective process. On the contrary, it would appear that it is a process aimed at restructuring the debt only with the bondholders.

   c. It cannot be established whether the scheme will be based on an insolvency law.

   d. Finally, it cannot be established with certainty that under this process the assets of Gambling Corp. will be subject to the supervision of a foreign court.

5. Foreign main proceedings are those that are initiated in the debtor's COMI.

6. Non-major foreign proceedings, in turn, are those that are commenced in a jurisdiction other than the debtor's COMI, where the debtor had a place of business in the jurisdiction.

7. The COMI of a debtor is presumed to be its place of incorporation, but this is rebuttable. Relevant factors in the COMI analysis include:
   a. location of headquarters;
   b. location of management;
   c. location of primary assets;
   d. location of a majority of debtor's creditors or a majority of the creditors that will be affected by the relief requested by the foreign representative; and
   e. jurisdiction whose law will apply to most disputes.

Commented [H(53]: Incorrect, the English scheme of arrangement has frequently been recognized under chapter 15 as a qualifying process

8. The English agreement to restructure the bonds is not being advanced in the COMI of Gambling Corp. The above, as it was not initiated where it was incorporated nor where it has its principal place of business, i.e. Greece. Likewise, according to the information of the case, Gambling Corp could not be considered as having a COMI different from its place of incorporation.

9. Notwithstanding the above, the English agreement to restructure the bonds could be considered as a foreign non-main proceeding since i) it was not initiated in the COMI of the debtor, and ii) it was initiated in England, where the debtor has a casino and betting parlors (London).

Question 4.2 [5 marks]

Oil Corporation is incorporated in Delaware and has its principal place of business in Texas. Oil Corp is facing a number of challenges to its business. First, ShipCo, one of its key customers, has filed a breach of contract lawsuit in Texas state court alleging that Oil Corp sold it contaminated oil that caused USD 1 billion in damage to ShipCo's container ships. Second, the US Department of Justice is investigating whether Oil Corp illegally purchased oil from countries subject to US sanctions. Third, Oil Corp. has missed a payment on its secured loan from USA Bank, and USA Bank is threatening to foreclose on an Oil Corp refinery located in the Philippines. Fourth, because of all these distractions, Oil Corp has forgotten to pay rent on its Houston, Texas office space and its landlord is threatening to evict it. What would be the effect of Oil Corp filing a chapter 11 petition on each of these four situations?

Under the Stay, the Bankruptcy Code prohibits certain actions involving interference with the assets of the debtor's estate from being taken anywhere in the world from the time the petition is filed. This automatic stay takes effect immediately upon the filing of any plenary petition.

The stay has certain statutory exceptions.

Taking into account this framework, in application of the automatic stay, a response will be given to each of the four scenarios outlined in the case:

First, ShipCo, one of its key customers, has filed a breach of contract lawsuit in Texas state court alleging that Oil Corp sold it contaminated oil that caused USD 1 billion in damage to ShipCo's container ships	The lawsuit would continue in Texas state court, which must determine whether Oil Corp caused the harm alleged by Shipco. The value alleged by Shipco for damages will be reduced in the insolvency proceeding to an amount determined through the class allocation process, if that process does not expire during the course of the case. In the event that the Texas state court orders Oil Corp to pay the $1 billion prior to the insolvency petition, the enforcement of such decision would be prohibited because it predates the insolvency proceeding.
Second, the US Department of Justice is investigating whether Oil Corp illegally purchased oil from countries subject to US sanctions	One of the exceptions to the automatic stay are criminal proceedings. Thus, since the Department of Justice is investigating Oil Corp for the commission of a crime, which is the purchase of oil from countries subject to U.S. sanctions, this process will continue and will not be stopped by the request for insolvency proceedings. Thus, the automatic stay does not affect the criminal proceeding initiated by the Department of Justice, and therefore it will continue its normal course.

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Commented [H(58]: Total marks 4/5

Commented [H(59]: Correct, 1 mark

Commented [H(60]: Incorrect, the lawsuit would be stayed, though the stay could be lifted on application to the bankruptcy court to reduce the claim to judgment

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Third, Oil Corp. has missed a payment on its secured loan from USA Bank, and USA Bank is threatening to foreclose on an Oil Corp refinery located in the Philippines	With the request of the insolvency process, automatically operates the stay of any process that USA Bank wishes to initiate against Oil Corp. This automatic stay is effective worldwide, so any action aimed at controlling Oil Corp's foreign assets or initiating a lawsuit against Oil Corp outside the U.S. judicial system is prohibited. Therefore, USA Bank could not seize an Oil Corp. refinery, even if it is located in the Philippines. Even if it is located in the Philippines.
Fourth, because of all these distractions, Oil Corp has forgotten to pay rent on its Houston, Texas office space and its landlord is threatening to evict it	Under the stay, once a request is made to initiate the insolvency process, any interference with the debtor's assets of the estate is prohibited. In particular, the Bankruptcy Code prohibits litigation of pre-bankruptcy claims. Therefore, the landlord could not evict the debtor for unpaid rents prior to the insolvency proceedings. In this regard, it should be noted that the Stay does not operate against the eviction of a debtor-lessee from a non-residential property when the lease has expired. However, taking into account that in this case the eviction would be requested not because the term expired, but because of the payment of the lease fee prior to the insolvency process, the Stay protects the debtor. Therefore, the lessor would not be able to evict him. Finally, it should be noted that post-application expenses, such as lease fees incurred after the application, are paid as administrative expenses on an ongoing basis, subject to court approval after notice and a hearing.

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Question 4.3 [6 marks]

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Oil Corp has filed for bankruptcy and is planning to sell its plastic manufacturing business through a 363 sale. The plastic manufacturing business operates under the trademark “Interconnect”, which is licensed from Plastic Corp. Oil Corp has invented several patented processes for plastic manufacturing, which it licenses to Plastic Corp. The main manufacturing facility for the plastic business is in Dallas, and Oil Corp has granted a lien on the facility to USA Bank to secure its USD 500 million loan.

Oil Corp thinks it will get the highest return for the plastics manufacturing business if it can (i) assume and assign the trademark license; (ii) reject the patent licenses so the purchaser has the exclusive right to use the patents; and (iii) sell the manufacturing facility free and clear of the USA Bank lien. Can Oil Corp achieve each of these goals without the consent of Plastic Corp and USA Bank? Why or why not?

Through a 363 sale, Oil Corp can sell its plastics manufacturing business free and clear of creditors' interests. Thus, for example, Oil Corp could sell the manufacturing facilities free of USA Bank's lien.

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This 363 sale requires court approval. For court approval, the debtor must establish that it proposes the transaction in accordance with its business judgment (in connection with which it has a fiduciary duty to consider the interests of creditors) and that the transaction is in the best interests of the estate as a whole.

Likewise, through the 363 sale, the debtor is permitted to transfer its interests in key contracts necessary to the operation of the business, even where such contracts contain restrictions on assignment.

Thus, in a sale scenario outside the rules of the 363 sale, it would not be possible to assign the manufacturing business because it includes a license of the trademarks, and trademark licenses are not assignable without the consent of the licensor, i.e. Plastic Corp. However, taking into account that with the 363 sale key contracts necessary for the operation of the business can be assigned, even when such contracts contain restrictions for their assignment, Oil Corp may assign the contract without requiring the consent of Plastic Corp.

Notwithstanding the foregoing, Oil Corp could not refuse to license the patents so that the purchaser has the exclusive right to use them without Plastic Corp's consent. The foregoing, since the licensees of patents and copyrights owned by the Debtor are protected under Sale 636 such that their licenses cannot be terminated in connection with the sale of the intellectual property without their consent. Therefore, in order for Oil Corp to reject the patent licenses licensed by Plastic Corp, it requires Plastic Corp's authorization.

On the other hand, the 363 sale does not require USA Bank's consent. However, USA Bank has the possibility to make a "credit offer" by offsetting a portion of the purchase price of the asset with the amount of its credit secured by the asset, i.e. 500 million. USA Bank may also assign its claim to a prospective buyer at a discount but bid on credit for the full value of the claim.

Commented [H(66]: Incorrect, the bankruptcy code overrides contractual restrictions on assignment but not those that arise from substantive law, like trademark licenses

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Commented [H(68]: Correct, 1 mark

Commented [H(69]: Also USA Banks lien will attach to the proceeds of the sale

*** End of Assessment ***