



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**.

Commented [DB1]: Please do me the courtesy of reading and complying with the instructions. If you don't do this I have to. If you do not comply with the instructions your assessment will be considered to be incomplete and will be returned to you unmarked in future. Many thanks.

ANSWER ALL THE QUESTIONS

Commented [H(2)]: Total marks 39.5/50

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

Commented [H(3)]: 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 [H(4)]: Correct, 1 mark

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

Commented [H(5)]: Correct, 1 mark

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

Commented [H(6)]: Correct, 1 mark

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

Commented [H(7)]: Correct, 1 mark

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

Commented [H(8)]: Correct, 1 mark

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

Commented [H(9)]: Correct, 1 mark

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

Commented [H(10)]: Correct, 1 mark

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

Commented [H(11)]: Correct, 1 mark

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

Commented [H(12)]: Incorrect, the correct response is (e)

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.

Commented [H(13)]: Correct, 1 mark

QUESTION 2 (direct questions) [10 marks]

Commented [H(14)]: Total marks 6/10

Question 2.1 (2 marks)

Commented [H(15)]: Total marks 1/2

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

An involuntary petition requires an allegation of insolvency, whereas the voluntary petition does not. In an involuntary petition the petitioning creditors require either:

- The debtor is not paying its debts as they fall due (unless disputed); or
- Within 120 days of the filing of the petition, a custodian, other than a trustee receiver, or an agent appointed or authorised to take charge of less than substantially all of the property of the debtor for the purpose of enforcing a lien against such property, was appointed or took possession.¹

Commented [H(16)]: Correct, 1 mark; by contrast the voluntary petition is filed by the debtor

Question 2.2 (2 marks)

Commented [H(17)]: Total marks 2/2

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

An act in violation of the stay constitutes contempt of court and is void or voidable. Failure to obtain relief from the stay may result in contempt sanctions, i.e. payment of the debtors' attorneys' fees and requiring the violator to take affirmative acts to undo the effect of its violation.

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Commented [H(19)]: Correct, 1 mark

Question 2.3 (3 marks)

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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 claim is "impaired" where the plan (if passed) would change the holder's legal, equitable and/or contractual rights altered and they will be paid less than the full value of their claim under the plan. Insider impaired claims must be disregarded from the votes, unless there is no impaired class. In re *DBSB North America Inc* 421 B.R. 133 (Bankr. S.D.N.Y. 2009), *aff'd*,

Commented [H(21)]: Correct, 1 mark. However, if the claim will receive nothing, the creditor does not get to vote and is deemed to reject the plan.

¹ Form B205 at 2

2010 WL 1223109 (S.D.N.Y. Mar. 24, 2010) the conduct of a creditor was such that the New York bankruptcy court ruled that it be stripped of its right to vote.

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?

Preferences

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

There is a rebuttable presumption of insolvency at the time of a transfer, and in the 90 days prior to the petition date and 1 year for insiders, in respect of preference payments. In respect actual and constructive fraudulent conveyances there is a requirements that the debtor was insolvent or became insolvent shortly after the transfer was made, the obligation incurred or as a result of the transaction.

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

An actual fraudulent conveyance, which requires it to be evidenced that that 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".²

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 U.S. bankruptcy courts were not established with most federal courts by Article III of the Constitution and, following the 1984 amendments to the Bankruptcy Code, referral of a "non-core" matter by a bankruptcy court to a district court was necessary for final determination. Bankruptcy judges were still permitted to hear and determine "core" proceedings (as listed non-exhaustively in statute), however the decision in *Stern v Marshall* confirmed that, even in core proceedings, a bankruptcy court cannot issue final orders that invade the Article III jurisdiction, even where a counterclaim by the debtor is otherwise treated as a core proceeding in law. In that matter, the state law claim could not be overreached by the final order.

The U.S. Supreme Court has however held that bankruptcy judges may determine a core proceeding over which they lack constitutional authority by issuing a report and recommendation for review by the district court, being the same procedure as for non-core proceedings. Agreement by consent may still be reached between the parties, who must now state in their pleadings whether they consent to entry of final orders of judgment by the bankruptcy court.

² Bankruptcy Code section 548

Commented [H(22)]: Total marks 2/3

Commented [H(23)]: Correct, 1 mark

Commented [H(24)]: Incorrect, insolvency is only required for preferences; it is possible to establish a fraudulent transfer even if the debtor was solvent at the time

Commented [H(25)]: Correct, 1 mark

Commented [H(26)]: Total marks 13.5/15

Commented [H(27)]: Total marks 2.5/3

Commented [H(28)]: Correct, 1 mark

Commented [H(29)]: Correct, 1 mark

Commented [H(30)]: Correct, 1/2 mark, also the bankruptcy court may resolve a challenge to the petition

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?

Although Chapter 15 closely follows the Model Law, it excludes the use of avoidance powers granted by the Bankruptcy Code. The provision has been interpreted widely, but not exclusively, to apply only to preferences and fraudulent conveyances and not the avoidance of pre-petition transactions.

A foreign representative can instead invoke avoidance powers in a plenary proceeding, such as under Chapters 7 or 11. Such a proceeding would be limited in scope to the debtor's U.S. assets and will be coordinated with the foreign proceeding.

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?

An interlocutory order is one that only deals with certain issues or claims, whereas final orders dispose of all issues. Interlocutory orders require the leave of the appellate court, whereas final orders may be appealed as of right. Because of the structure of the method of the creation of the bankruptcy courts (i.e. by legislation, rather than the Constitution), bankruptcy judges have limited jurisdiction to enter final orders, other than on core bankruptcy issues. Whilst a bankruptcy court may hear non-core proceedings if they are sufficiently proximate to the bankruptcy proceedings, that will not be a final order and instead, it would submit findings of fact and conclusions of law to the district court for final determination. From the district court or Bankruptcy Appellate Panel there is a further appeal right to the circuit court of appeals.

Question 3.4 (5 marks)

What fiduciary duties do directors of Delaware corporations owe and to whom are the duties owed in the ordinary course of business? To whom are duties owed when the corporation is potentially or actually insolvent?

Whilst Director's duties are a matter of state law and incorporation, the position in Delaware is that Director's duties are owed to the corporation and its shareholders, rather than the creditors, even where the corporation is potentially insolvent – unlike under English law. The Delaware Supreme Court has confirmed that there is no suggestion that directors owe duties to creditors, even when operating in the twilight period or is insolvent.³ The fiduciary duties are limited to a duty of loyalty to the corporation's best interest and a duty of care in educated decision-making but are protected by the business judgment rule, provided they acted in good faith (which is a rebuttable presumption), save for in instances of gross negligence.

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

Question 4.1 [4 marks]

³ North Am Catholic Educational Programming Foundation, Inc v Gheewalla, 930 A.2d 92, 103 (Del 2007)

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Commented [H(32)]: Correct, 1 mark

Commented [H(33)]: It's not clear what distinction you're drawing here. Preferences and fraudulent conveyances are types of claims to void pre-petition transactions under the bankruptcy code.

Commented [H(34)]: Correct, 1 mark. The foreign representative may also press claims under foreign or non-bankruptcy US law

Commented [H(35)]: Total marks 4/4

Commented [H(36)]: Correct, 1/2 mark

Commented [H(37)]: Correct, 1/2 mark

Commented [H(38)]: Correct, 1/2 mark

Commented [H(39)]: Correct, 1/2 mark

Commented [H(40)]: Correct, 1 mark

Commented [H(41)]: Correct, 1 mark

Commented [H(42)]: Total marks 5/5

Commented [H(43)]: Correct, 1 mark

Commented [H(44)]: Correct, 1 mark

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Commented [H(47)]: Correct, 1 mark

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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.

Given the debt proposed to be compromised is subject to English law and Gambling Corporation operates in England, there may be sufficient connection to the jurisdiction for a scheme to be sanctioned. It is not clear from the facts if it is anticipated there will also be a process initiated in Greece, where Gambling Corporation's COMI appears to be. However, subject to the English Court sanctioning the scheme, it seems that any proceedings in the US would be as foreign non-main proceedings and could be commenced under Chapter 15 for the foreign representative filing a petition for recognition. We are told the company operates a business in many international cities, including Las Vegas, so it has a place of business in the US and is likely to have property in the US (to satisfy the requirements at section 109).

A scheme of arrangement, is likely to satisfy the criteria of UNCITRAL Model Law and incorporated into the Bankruptcy Code as being "judicial or administrative proceeding in a foreign country...under a law relating to insolvency or adjustment of debt in which proceeding the [debtor's assets and affairs] are subject to control or supervision by a foreign court for the purpose of reorganization or liquidation."⁴ Case law confirms schemes of arrangement have been recognised previously.

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?

1. ShipCo

Upon Chapter 11 proceedings being initiated, there would be a stay of the breach of contract suit against Oil Corporation, unless relief was obtained. However, ShipCo may still have a contingent claim against Oil Corporation as an unsecured creditor for the claim in the estate.

2. US Department of Justice

As criminal and regulatory investigations are exempted by statute from the general stay, these may continue.

3. USA Bank

Upon the Chapter 11 proceedings, the worldwide automatic stay of proceeding against the debtor's property would prevent the bank from taking action to foreclose on the refinery in the Philippines, unless relief was obtained. It is not clear what the value of the security vs the debt

⁴ 11 U.S.C.S 101(23)

Commented [H(50)]: Correct, 1 mark, and therefore could not be a foreign main

Commented [H(51)]: Correct, 1 mark, and the requirement of an establishment is met by the casino in London

Commented [H(52)]: True, though one could also use a retainer paid to US counsel to meet this requirement

Commented [H(53)]: Total marks 5/5

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Commented [H(56)]: Correct, 1 mark

Commented [H(57)]: Correct, 1 mark

and available assets, but it may be arguable that there is no equity and/or it is not necessary for the reorganisation.

4. Landlord

The filing of Chapter 11 proceedings would stop the landlord being able to take eviction actions. The Bankruptcy Code gives the tenant a deadline of 120 days to assume or reject the lease (subject to any application to extend the deadline by a further 90 days).⁵ If Oil Corporation wanted to assume the lease, it would need to provide a plan to cure the pre-petition arrears.⁶

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Question 4.3 [6 marks]

Commented [H(59)]: Total marks 4/6

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?

(i) assume and assign the trademark license

To assume the contract Oil Corp would need to cure defaults and give Plastic Corp sufficient assurances of its future performance⁷, which clearly it cannot do if the intention is to seek to assign the licence to the purchaser. In any event, trademark licences are not assignable absent licensor consent⁸ so Plastic Corp ought to be engaged to try and get them onside – they may even be a potential purchaser of the business.

Commented [H(60)]: Correct, 1 mark

Commented [H(61)]: Correct, 1 mark

(ii) reject the patent licenses so the purchaser has the exclusive right to use the patents

Yes, Oil Corp could reject the licenses but needs to recognise that it will create an unsecured breach of contract claim in damages.

Commented [H(62)]: Incorrect, the rejection would not terminate the licenses under the provisions applicable to patent licenses under 365(n) and therefore consent of Plastic Corp would be required to convey exclusivity

(iii) sell the manufacturing facility free and clear of the USA Bank lien.

Yes, the benefit of a Chapter 11 petition debtor in possession proceedings provide for the ability to sell assets free and clear of liens (with the charge instead attaching to the sale realisations). However, this is subject to the consent of the Bank, the debtor having some equity in the facility over the debt and/or the Bank's interest capable of being satisfied in money – which it appears could be based on the facts set out.⁹ The Bank may also wish to credit bid, albeit there is no indication of the value of the business vs the facility over which it has a lien.

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Commented [H(64)]: Correct, 1 mark

* End of Assessment *

⁵ 11 U.S.C. § 365(d)(4)(A)

⁶ 11 U.S.C. § 365(b)(1)(A)

⁷ Idem s 365(b)(1)

⁸ *Re Trump Entertainment Resorts Inc*, 526 BR 116 (Bankr D Del 2015)

⁹ S363(f)