



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

Commented [H(1): Total marks 35/50

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

Commented [H(2): 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(3): 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(4): 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(5): 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(6): 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(7): 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(8): 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

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.

Commented [H(9)]: Incorrect, the correct answer is (a). The scope of the stay in chapter 15 is territorially limited, unlike in other chapters of the Bankruptcy Code.

Question 1.8

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".

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

Question 1.9

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).

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

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(12)]: Correct, 1 mark

QUESTION 2 (direct questions) [10 marks]

Commented [H(13)]: Total marks 7/10

Question 2.1 (2 marks)

Commented [H(14)]: Total marks 2/2

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

A voluntary petition may be commenced by a debtor whereas an involuntary petition is commenced by creditors against an eligible debtor. A voluntary petition may be commenced regardless of the solvency of the debtor whereas an involuntary petition can only be commenced if the petitioning creditors are able to establish either that the debtor is generally not paying its debts as they become due or that, within 120 days before filing the petition, a custodian was appointed or took possession, 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.

Commented [H(15)]: Correct, 1 mark

Commented [H(16)]: Correct, 1 mark

Question 2.2 (2 marks)

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

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

Violation of an automatic stay constitutes contempt of court and any such act in violation of the automatic stay is void or voidable, depending on the circuit in which the bankruptcy is pending.

Commented [H(18)]: Correct, 1 mark

The violation may result in the imposition of contempt sanctions, which may include the payment of the debtors' attorneys' fees and requiring the violator to take affirmative acts to undo the effect of its violation. A daily fine may also be imposed until the stay violation has been rectified.

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

Question 2.3 (3 marks)

Commented [H(20)]: Total marks 1/3

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 unless the proposed plan leaves the holder's legal, equitable, and contractual rights unaltered. However, a claim may be deemed unimpaired where the plan reverses the contractual acceleration by curing any monetary default and compensating the holder for any damages.

Commented [H(21)]: Correct, 1 mark

Only the holder of an impaired claim is entitled to vote on a proposed plan of reorganisation. However, the holder of an impaired claim may not be entitled to vote if the plan is confirmed by "cramming down" dissenting impaired classes. In a cramdown, at least one impaired class (excluding insiders) must have voted to accept the plan and the plan must not discriminate unfairly and must be fair and equitable to the non-consenting impaired classes.

Commented [H(22)]: Incorrect, they vote but the vote is disregarded. Impaired claims that will receive nothing under the plan cannot vote and are deemed to reject the plan.

In those circumstances, the class definition can become a battleground for the creditors and the creditors may also challenge the reasonable basis for the separate classification.

Question 2.4 (3 marks)

Commented [H(23)]: Total marks 2/3

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?

A preference claim.

Commented [H(24)]: Correct, 1 mark

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

Setoff.

Commented [H(25)]: Incorrect, the correct response is preference.

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

Actual fraudulent conveyances.

Commented [H(26)]: Correct, 1 mark

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

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Question 3.1 (3 marks)

Commented [H(28)]: Total marks 2/3

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

Prior to the issuance of the US Supreme Court decision of *Stern v Marshall*, it appeared to have been well-established that the bankruptcy courts' jurisdiction to resolve issues presented in core proceedings. Non-core proceedings could only be heard if they are sufficiently related to a bankruptcy proceeding, but the bankruptcy court cannot make a final determination. The bankruptcy court would have to submit its findings of fact and conclusions of law to the district court for its final decision. This was because bankruptcy courts are creatures of federal legislation rather than established by Article III of the US Constitution.

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

In 2011, the *Stern v Marshall* case established that the bankruptcy court cannot issue final orders that invade the courts' Article III jurisdiction. In brief, *Stern v Marshall* was a case which involved a bankruptcy claim filed against a debtor. The debtor filed a counterclaim, the issues of which were also the subject of separate state court proceedings. The bankruptcy court issued its decision first before the state court. This decision was then affirmed by the state court jury. Even though a counterclaim may be a core proceeding as to which a bankruptcy court can issue a final order, the Supreme Court found that the bankruptcy court's issuance of a final order over a state law claim was unconstitutional under Article III.

Commented [H(30): Correct, 1 mark, but bankruptcy courts can enter final orders on challenges to petitions or where the parties consent

Question 3.2 (3 marks)

Commented [H(31): Total marks 0/3

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?

Voluntary and involuntary petitions under the Bankruptcy Code automatically invoke worldwide automatic stays to protect property of the estate from creditor enforcement actions.

The foreign representative can obtain equivalent relief by way of filing a petition for the recognition of a foreign main proceeding (which would be limited to the property of the debtor within the territorial jurisdiction of the United States). Alternatively, in the case of the recognition of a foreign non-main proceeding, the foreign representative can obtain a stay or other assistance by way of an application for relief. The applicable test in this situation is the same as in a request for an injunction, i.e. the likelihood of success on the merits, risk of irreparable harm, balancing of the equities, and the public interest.

Commented [H(32): Incorrect, the foreign representative is barred from invoking the avoidance powers, but may bring equivalent claims under foreign or non-bankruptcy US law, or may file a plenary case to get access to the avoidance powers.

Question 3.3 (4 marks)

Commented [H(33): Total marks 4/4

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?

A final order is one which disposes of all issues, leaving nothing further to be decided. An interlocutory order resolves only some issues or claims. The difference between a final and interlocutory order can also be an elusive one, where the issue resolved is one of broad applicability, such as the post-petition interest rate applicable to the debtor's obligations. The US Supreme Court in *Bullard v Blue Hills Bank*, 135 S Ct 1686 (2015) has held that a bankruptcy order resolving a discrete dispute is a final order for appeals purposes.

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Commented [H(35): Correct, 1/2 mark

A final order may be appealed as of right, whereas interlocutory orders may be appealed only with leave of the appellate court. For bankruptcy court orders, there is an exception that orders extending the period of exclusivity to propose a plan are appealable as of right (notwithstanding that it is an interlocutory order).

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

Appeals from bankruptcy court decisions are heard by the district court for the district where they sit. Some bankruptcy appeals are heard by the Bankruptcy Appellate Panel (BAP), such as in the First, Sixth, Eighth, Ninth, and Tenth Circuits. In these circuits, the appellant also has the option to request that the appeal be heard by the district court. From the district court or BAP, there is a further appeal of right to the circuit court of appeals.

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Commented [H(39): Correct, 1 mark

In rare circumstances, an appeal from a bankruptcy court may be leapfrogged to the court of appeals where the bankruptcy court or district court certifies either that (i) the appeal raises a question of law as to which there is no controlling decision or requires resolving conflicting

controlling decisions; or (ii) an immediate appeal may materially advance the progress of the case. The court of appeals may nonetheless exercise its discretion not to accept such a case.

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?

A director of a Delaware corporation owes a fiduciary duty of loyalty to the corporations' best interest and a duty of care in educated decision-making. However, they are protected from liability for errors of judgment by the business judgment rule (which creates a rebuttable presumption that the board of directors acted in good faith on the basis of reasonable information).

These duties are owed to the corporation and its shareholders, and not to the corporation's creditors even if the corporation is potentially insolvent. This was determined by the Delaware Supreme Court in *North Am Catholic Educational Programming Foundation, Inc v Gheewalla*, 930 A.2d 92, 103 (Del 2007). Creditors protect their interests by bringing derivative claims on behalf of the insolvent corporation.

Even if the company is insolvent, there is no obligation on the board of the company to cease operations and liquidate. In such situations, the board may continue to pursue strategies to maximise the value of the firm in good faith (See *Trenwick Am Litig Trust v Ernst & Young, LLP*, 906 A.2d 168 (Del Ch 2006)).

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

Question 4.1 [4 marks]

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.

Gambling Corporation's scheme of arrangement could be granted recognition under US chapter 15 assuming that there is a foreign representative appointed to administer the scheme of arrangement in England. The foreign representative may apply for recognition of the English scheme of arrangement in the US, as the definition of "foreign proceeding" (i.e. 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 reorganisation or liquidation) is broad. An English scheme of arrangement would constitute a foreign proceeding.

The next consideration would therefore be whether the English scheme of arrangement is a foreign main or non-main proceeding. This involves an analysis of whether England is Gambling Corp's centre of main interest (COMI). The COMI should be ascertainable by its creditors or other third parties on the basis of objective evidence.

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

Commented [H(42)]: Correct, 1 mark

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

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

Commented [H(45)]: Correct, 1 mark

Commented [H(46)]: Total marks 8/15

Commented [H(47)]: Total marks 3/4

Commented [H(48)]: Specifically, where COMI is in the jurisdiction of the proceeding, foreign main recognition is appropriate.

There is a rebuttable presumption that the COMI is the place of incorporation. In this case, since Gambling Corp is incorporated and has its principal place of business in Greece, these are factors that point towards the English scheme of arrangement being recognised as a foreign non-main proceeding. On the other hand, key factors which may point towards recognising the English scheme of arrangement as a foreign main proceeding would be (i) the location of a majority of the debtor's creditors or where a majority of the creditors that will be affected by the relief requested by the foreign representative; and (ii) the jurisdiction whose law will apply to most disputes. Since the scheme of arrangement is being used to restructure these bonds (which are governed by English law) and since Gambling Corp has casinos and betting parlors in London as well (i.e. an establishment in the jurisdiction prior to commencement of the chapter 15 proceedings), these are additional strong factors which point towards the English scheme of arrangement being recognised as a foreign main proceeding.

Commented [H(49)]: Correct, 1 mark

Commented [H(50)]: Correct, 1 mark

Commented [H(51)]: Correct, 1 mark

Question 4.2 [5 marks]

Commented [H(52)]: Total marks 5/5

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?

A Chapter 11 petition generally results in a worldwide automatic stay from the moment the petition is filed of any proceeding against Oil Corp or its property and will therefore present Oil Corp with breathing space to continue operating more or less in the ordinary course of business.

Commented [H(53)]: Correct, 1 mark

Specifically, in the first situation in relation to ShipCo's existing lawsuit for a breach of contract in Texas state court, this will be stayed.

Commented [H(54)]: Correct, 1 mark

In the second situation, in relation to the US Department of Justice's investigations into Oil Corp's alleged breaches of US sanctions, these would constitute criminal proceedings which are exempted under statute from the stay.

Commented [H(55)]: Correct, 1 mark

In the third situation, in relation to USA Bank's threats to foreclose on an Oil Corp refinery located in Philippines, the stay would apply as well as it applies to any interference with the property of the estate anywhere in the world.

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

In the fourth situation, in relation to the landlord's threats to evict Oil Corp, the stay would apply unless the terms of the lease agreement provide that upon any missed rental payments, the lease will automatically expire. In such a case, the eviction of Oil Corp would be exempted from the stay.

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

Question 4.3 [6 marks]

Commented [H(58)]: Total marks 3/6

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) Oil Corp can elect to assume and assign the contract, meaning Oil Corp will transfer the Oil Corp's rights under the trademark license to a third party. The transferee must give the counterparty adequate assurances of future performance. However, Oil Corp may not be successful as the assignment would be subject to Plastic Corp's consent, since the trademark license would constitute intellectual property licensing law which Plastic Corp cannot be compelled to accept performance from the third party.

Commented [H(59)]: Correct, 1 mark

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

(ii) Oil Corp can elect to reject the patent licenses. If it does, then the effect of the rejection will be that Oil Corp is deemed to have breached the contract immediately before the petition date, giving Plastic Corp an unsecured pre-petition claim in damages.

Commented [H(61)]: The patent licenses are protected from termination by section 365(n), so Plastic Corp's consent would be required to grant exclusivity to purchaser of the patents.

(iii) under a 363 sale, the manufacturing facility may be sold free and clear of creditor interests. However, 11 USC, §363(k) also provides that a creditor holding a security interest in property that is to be sold may "credit bid" by offsetting a portion of the purchase price of such property against the amount of its claim secured by the property. As such, in this case, USA Bank would be entitled to offset a portion of the purchase price of the manufacturing facility against the amount outstanding under the USD 500m loan.

Commented [H(62)]: Correct, 1 mark, and the lien would attach to the proceeds

*** End of Assessment ***