



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]

Commented [H(2): Total marks 7/10

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

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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

Commented [H(5): Incorrect, the correct response is (d)

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

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.

Commented [H(6): Incorrect, the correct response is (a). The shortest pre-packs have been resolved in less than 24 hours.

Question 1.5

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.

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Question 1.6

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.

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(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]

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

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?

A voluntary petition is commenced by a debtor and does not require the debtor to establish insolvency, whereas an involuntary petition is commenced by a creditor alleging that the debtor is generally not paying its debts as they become due.

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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?

A violation of the automatic stay constitutes contempt and may result in the imposition of contempt sanctions against the violator, which may include payment of the debtor's attorneys' fees and requiring the violator to take affirmative acts to undo the effect of its violation. A violation of the automatic stay is void or voidable if it is an affirmative act that changes the status quo of the estate's property. A violation must be rectified, in default of which, the court may impose coercive contempt sanctions such as a daily fine paid to the court until the violation has been rectified.

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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?

If a proposed plan of reorganisation in a Chapter 11 reorganisation alters the legal, equitable and / or contractual claims or interests belonging to holders in a certain class, those claims are considered impaired.

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Impaired classes are entitled to vote on the plan but it is not necessary for all impaired classes to approve the plan. If at least one impaired class approves the plan, the other impaired classes can be "crammed down" as long as the other requirements of confirmation¹ are met

Commented [H(22): Incorrect, an impaired claim that will receive nothing under the plan is not entitled to vote and is deemed to reject the plan

¹ 11 USC (or Bankruptcy Code), section 1129

and the plan does not "discriminate unfairly" and is "fair and equitable" to the non-consenting impaired classes².

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?

Preference

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

Constructive fraudulent conveyance

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

Actual fraudulent conveyance

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?

Prior to 2011 the bankruptcy court's jurisdiction to resolve issues in core proceedings seemed well established. Whether a proceeding was core³ or non-core⁴ was the key consideration as to whether the bankruptcy court could exercise jurisdiction to issue a final order. However, in 2011 the US Supreme Court held in *Stern v Marshall*⁵ that even in core proceedings, a bankruptcy court cannot issue final orders that invade or encroach upon Article III jurisdiction⁶. In *Stern* a state court's jury verdict in relation to a counterclaim was upheld over the bankruptcy court's final determination (which had been issued first but appealed) by the US Supreme Court on the basis that the bankruptcy court's final determination in relation to a state law claim was unconstitutional under Article III. Since *Stern* the US Supreme Court has held that a core proceeding over which the bankruptcy court lacks constitutional authority can be determined by the bankruptcy court by the issuance of a report and recommendation for review by the

² Idem, section 1129(b)

³ 11 USC, s157(b)(2)

⁴ If a matter is non-core and not related to a bankruptcy proceeding the bankruptcy court can hear, but not make a final determination in, the matter. Instead it submits proposed findings of fact and conclusions of law to the district court to which interested parties may object, for the district court's final decision. If the matter does not fall within the "related to" jurisdiction and there is no other basis for federal court jurisdiction, the matter must be resolved in state court.

⁵ 564 US 462 (2011)

⁶ Article III of the US Constitution establishes the jurisdiction of most federal courts. However the bankruptcy court's jurisdiction was established by the 1978 Bankruptcy Code.

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Commented [H(25)]: Incorrect, while a constructive fraudulent conveyance may involve insolvency, there are other circumstances in which a constructive fraudulent conveyance can occur without insolvency

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Commented [H(28)]: Total marks 2.5/3

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

Commented [H(30)]: Correct, 1 mark

district court⁷, which is the same procedure as in non-core proceedings, or, with the consent of the parties, may issue final orders⁸. To implement the effect of these rulings, amendments to the Bankruptcy Rules have been made such as the requirement for litigants to state in their pleadings whether they consent to the entry of final orders or judgment by the bankruptcy court⁹, and by permitting a district court that determines that a bankruptcy court does not have jurisdiction to enter a final order to treat the order as proposed findings of fact and conclusions of law¹⁰.

Commented [H(31)]: Correct, 1/2 mark, also a bankruptcy court has authority to adjudicate challenges to petitions for bankruptcy

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?

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A foreign representative in a Chapter 15 proceeding may not invoke the use of avoidance powers (most widely interpreted to relate to avoidance of preferences and fraudulent conveyances) provided by the Bankruptcy Code¹¹. To obtain equivalent relief, a foreign representative can invoke the Bankruptcy Code's avoidance powers in a plenary proceeding such as chapter 7 or 11¹². These powers can be invoked by the foreign representative in existing proceedings commenced by a debtor or its creditors prior to the involvement of the foreign representative. Alternatively, a plenary proceeding can be commenced by the foreign representative after Chapter 15 recognition of the foreign proceeding¹³. The second option is limited to the debtor's US assets and will be coordinated in the foreign proceeding¹⁴. The commencement of a plenary proceeding by the foreign representative may be required due to relief under other applicable law being considered unsatisfactory, such as where the statute of limitations has expired or applicable law is not as broad in scope so as to accommodate claims for constructive fraudulent conveyance.

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Commented [H(34)]: Correct, 1 mark, also the foreign representative can rely on foreign and non-bankruptcy US law to the extent applicable.

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?

Commented [H(35)]: Total marks 3.5/4

Final orders may be appealed as of right whereas interlocutory orders may be appealed only with leave of the court. This framework is equally applicable to order from the bankruptcy court¹⁵. However, the distinction as to what is a final or interlocutory order can sometimes be obscure where an order not only resolves a dispute between two parties, but determines an issue such as pre-petition interest, which has broader application, as is often the case in bankruptcy proceedings where multiple parties have vested interests which might be affected by such a ruling. To mitigate against the uncertainty that can result from these nuanced

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

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

⁷ *Executive Benefits Ins Agency v Arkinson*, 134 S.Ct.2165 (2014)

⁸ *Wellness Int'l Network, Ltd. V. Sharif*, 135 S Ct 1932 (2015)

⁹ Fed R Bankr P 7008

¹⁰ Fed R Bankr P 8018.1.

¹¹ Bankruptcy Code s 1521 (a)(7) (excluding from discretionary relief that may be granted upon recognition "relief available under sections 522,544,545,547,548,550, and 724(a)")

¹² 11 USC, s 1523(a)

¹³ Idem, s 1511

¹⁴ Idem, s 1528

¹⁵ This is subject to the exception that orders extending the period of exclusivity to propose a plan under Chapter 11 are appealable as of right (28 USC, s 158(a)(2))

situations in the context of an appeal, the US Supreme Court has held that a bankruptcy order resolving a discrete dispute is a final order for the purpose of appeals¹⁶.

Commented [H(38)]: Correct, 1/2 mark, whereas an interlocutory order only resolves part of an issue or dispute

As to the effect of an order of the bankruptcy court which constitutionally final on the basis that the bankruptcy court had the requisite authority to make it, such order is not final for the purpose of appeal unless it resolves the entire issue in dispute. However, an order from bankruptcy resolving an entire dispute which may be final for the purpose of appeal, may not be constitutionally final if the parties did not consent to the bankruptcy court's jurisdiction. If the order is final in the constitutional sense (because it was a ruling in a core proceeding) and resolves the entire dispute therefore being final for the purpose of an appeal, the standard of review applied to conclusions of law is *de novo* and to findings of fact is review for abuse of discretion. If the ruling is given in a non-core proceeding or the bankruptcy court lacked the requisite authority to enter a final order, the standard of review is a *de novo* review of all findings of fact and conclusions of law to which a party has objected.

Appeals of decisions of the bankruptcy court will generally be heard by the district court for the district in which they sit¹⁷. However, in some circuits, bankruptcy appeals are heard by a Bankruptcy Appellate Panel (BAP) convened from judges of the Bankruptcy courts within the circuit (unless a party exercises the right to request that the appeal is heard by the district court).

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

Assuming there is an appeal as of right available, an appeal from the district court or BAP will be heard by the circuit court of appeals and is reviewed *de novo* as to conclusions of law and for abuse of discretion for findings of fact¹⁸. In rare cases, an appeal may leapfrog the district court of BAP level and go straight to the courts of appeal where either the bankruptcy or district court certifies that either (i) the appeal raises a question of law regarding which there is no controlling decision of the circuit of the US Supreme court, or requires resolving conflicting controlling decisions; or (ii) immediate appeal may materially advance the progress of the case¹⁹. The court of appeals has discretion whether to accept a case certified as justifying a leapfrog of the district court or BAP level.

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?

Under Delaware law directors owe a fiduciary duty of loyalty to a Delaware corporation's best interest. In relation to other duties owed in the ordinary course of business under Delaware law, directors owe a duty of care in educated decision-making. However, directors are protected from liability for errors of judgment by operation of the business judgment rule which provides a rebuttable presumption that directors acted in good faith on the basis of reasonable information.

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

In order to rebut this presumption the alleging party must establish that a majority of the board of directors were not reasonably informed, did not honestly believe that their decision was in

¹⁶ *Bullard v Blue Hills Bank*, 135 S Ct 1686 (2015)

¹⁷ The first appeal will go to a randomly assigned judge who will then usually hear all future appeals from those particular bankruptcy proceedings.

¹⁸ Circuit courts of appeals are reluctant to let parties skip the appeal at district court or BAP level because this acts as an effective filtering mechanism for appeals not warranting pursuit to the court of appeals and helps parties refine their arguments in case the appeal does go through the whole process.

¹⁹ 28 USC, s 158(d).

the corporation's best interest, or were not acting in good faith. In the absence of rebuttal of the presumption that protects directors under the business judgment rule, directors will not be liable for breach of duty unless gross negligence can be shown. In addition, directors may be exculpated by the terms of a corporation's certificate of incorporation from liability for breach of the duty of care. However a breach of the duty of loyalty cannot be overridden by any terms in the certificate of incorporation²⁰.

Another exception to the operation of the business judgment rule and the protection it affords, is where a board majority approves a transaction but the members are not disinterested and independent, or a controlling shareholder is on both sides of the transaction (with an ability to exert influence over the directors and their decision making). In these circumstances, any transaction approved by the board majority will be void unless the 'entire fairness' standard is satisfied.

Where the corporation is insolvent or potentially insolvent, directors duties are still owed to the corporation and its shareholders, not its creditors. This was confirmed in the case of *North Am Catholic Educational Programming Foundation, Inc v Gheewalla*, 930 A.2d 92, 103 (Del 2007) where the Delaware Supreme Court held that "[I]ndividual creditors of an insolvent corporation have no rights to assert direct claims for breach of fiduciary duty against corporate directors. Creditors may nonetheless protect their interest by bringing derivative claims on behalf of the insolvent corporation...". This reflects the US generally debtor friendly inclination and proffers explanation as to why there is no equivalent under US law of the "wrongful trading" or "deepening insolvency" concepts²¹ which place obligations on directors to take proactive steps once it becomes apparent that the company is unable to continue as a going concern.

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

Commented [H(46)]: Correct, 1 mark

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.

Chapter 15 implements, with modification, the UNICITRAL Model Law (Model Law) which when invoked commences an ancillary as opposed to plenary proceeding. This means that the US court will provide assistance to a foreign representative, in this case the foreign representative in the English insolvency proceeding through which the scheme of arrangement to restructure Gambling Corp's bond's is being effected.

As long as the foreign representative can establish that the English court with respect to Gambling Corporation is pending and that the foreign representative is empowered to act by

²⁰ Del Gen Corp L, s 102(b)(7)

²¹ See *Trenwick Am Litig Trust v Ernst & Young, LLP*, 906 A.2d 168 (Del Ch 2006) in which the court held "Delaware law imposes no absolute obligation on the board of a company that is unable to pay its bills to cease operations and to liquidate. Even when the company is insolvent, the board may pursue, in good faith, strategies to maximize the value of the firm."

the proceeding²². It is unlikely that the Chapter 15 exclusions contained in 11 USC section 101(23) would apply in this case on the basis that Gambling Corporation has a presence, place of business and assets in the US (given the Casino in Las Vegas) so as to be capable of being subject to Chapter 7 proceedings.²³

The English proceedings through which the scheme of arrangement is to be effected would likely qualify as a foreign proceeding as it falls within the broad definition of "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"²⁴. In this case the scheme of arrangement is intended to adjust Gambling Corp's debt through a restructuring of the liabilities owed pursuant to the bonds.

On the basis of the information provided, and in particular, noting that Gambling Corp is incorporated and has its principal place of business in Greece, it is likely that Gambling Corp's center of main interest (COMI) will be considered to be Greece. This is based on the presumption (which although rebuttable²⁵) that COMI is presumed to be the place of a debtor's incorporation. It is not clear whether where the location of primary assets or management is based not where the majority of creditors are located or which jurisdiction the law of will apply to most disputes. However, unless these factors would serve to rebut the presumption of COMI being Greece, the English proceeding would likely be deemed foreign non-main proceedings. This is on the basis that the casino in Las Vegas is considered an "establishment" – a place where Gambling Corp carries out non-transitory economic activity – prior to the commencement of the Chapter 15 proceedings.

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?

Upon filing the filing of a plenary petition, including that filed under chapter 11, an automatic stay²⁶ takes effect. Generally speaking, this prevents the commencement or continuation of any action (including legal proceedings) which would interfere with the property of Oil Corp's estate anywhere in the world. The automatic stay will provide Oil Corp with breathing room to formulate its restructuring plan, negotiate with creditors and realise the value of its assets in an orderly process culminating in the payment of creditor claims.

The scope of the automatic stay is broad. However, there are certain statutory exceptions.

²² 11 USC, s 101(23)

²³ Idem, s 109

²⁴ 11 USC, s 101(23)

²⁵ In re SPhinX, Ltd, 351 BR 103, 117 (Bankr SDNY 2006)

²⁶ 11 USC, s 362

Commented [H(49)]: Correct, 1 mark, whereas if the COMI was in the UK, the scheme could be recognized as foreign main proceedings

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

Commented [H(51)]: Incorrect, the casino in London is the relevant establishment because the foreign proceedings are happening the UK

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

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

In relation to ShipCo's claim for damages arising from an alleged breach of contract, as this claim falls under section 362(a)(1) of the Bankruptcy Code, being a legal proceeding commenced prior to the filing of the Chapter 11 petition, its continuation would be stayed.

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The investigation into whether Oil Corp illegally purchased oil from countries subject to US sanctions by the US Department of Justice appears to fall into the category of a regulatory investigation, which is one of the statutory exceptions provided by section 362(b) of the Bankruptcy Code, to the application of the automatic stay.

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

In relation to Oil Corp's default in meeting payment obligations under its secured loan from USA Bank, and USA Bank threat to foreclose on an Oil Corp refinery located in the Philippines, the automatic stay would take effect unless USA Bank successfully obtained an order (on motion to the court seized of the plenary proceedings filed under Chapter 11), permitting foreclosure. The court may lift the stay or grant relief, insofar as it prevents the foreclosure on the Oil Corp refinery, pursuant to 11 USC, 362(d) in certain circumstances. Firstly, if USA Bank can show that there is a lack of adequate protection of its interest in the refinery as its value may decline during the course of the Chapter 11 proceedings resulting in USA Bank making less than full recovery. In this situation if adequate protection is deemed to be lacking, Oil Corp can attempt to avoid the stay being lifted if it provides the "indubitable equivalent" of the value that might otherwise be lost (typically through periodic payments or grant of a lien on unencumbered estate property)²⁷. Secondly, if it can be shown that Oil Corp has no interest in the property and it is not necessary for the reorganization, the court may lift the stay on USA Bank's foreclosure. To avoid the stay being lifted on account of this circumstances, Oil Corp must show a reasonable prospect of reorganization within a reasonable time. Thirdly, if the sole asset of Oil Corp is real property encumbered by the interest of USA Bank (which appears unlikely given the nature of Oil Corp's business), and Oil Corp does not file a plan within 90 days or made monthly payments at a non-default contract rate of interest, the court may lift the stay and permit USA Bank to foreclose. Fourthly, as USA Bank is secured by real property, if the court found that Oil Corp's filing for bankruptcy "was part of a scheme to delay, hinder, or defraud creditors that involved either (a) transfer of all or part ownership of, or other interest in, such real property without the consent of USA Bank or court approval; or (b) multiple bankruptcy filings affecting real property", the stay may be lifted. It is not known whether there is any evidence that either of these situations has occurred. In addition to the four circumstances above, the court has a broad discretion to terminate, annul retrospectively or modify the stay to permit a specific act, such as USA Bank foreclosing on the oil refinery. The court may also condition the continuance of the stay on USA Bank exercising its right of foreclosure on Oil Corp's compliance with a condition to protect USA Bank's interest in the property, on cause being shown²⁸.

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

Finally, in relation to Oil Corp forgetting to pay rent on its Houston, Texas office space and the landlord threatening to evict it: the stay would prima facie apply unless the lease has expired (in which case it falls within the statutory exceptions which prevent the automatic application of the stay under section 362(b) of the Bankruptcy Code). Where Oil Corp's interest in the lease continues because the term of the lease has not yet expired, notwithstanding that the lease is in respect of property owned by a third party, the stay will operate so as to prevent eviction so as to avoid irreparable harm to the estate.

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

Question 4.3 [6 marks]

Commented [H(58)]: Total marks 4.5/6

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

²⁷ Idem, section 361 and section 362(d)

²⁸ 11 USC, s 362(d)

“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?

Oil Corp's election to assume and assign the trademark license granted by Plastic Corp as part of the section 365 sale, must be confirmed within 60 days of the petition date in the case of bankruptcy under Chapter 7, or once the plan for reorganization has been confirmed if the bankruptcy is proceeding under Chapter 11. The election to assume or reject must be based on the business judgment of Oil Corp that the reorganization or liquidation of assets to pay creditors will be facilitated. In this case we are told that the election to assume and assign the trademark license (in conjunction with the other intended transactions) will enable the highest return for the plastics manufacturing business. On the basis that this will result in the best possible recovery for creditors, this would appear to satisfy the business judgment test. In this scenario, the transferee must give adequate assurance of future performance²⁹.

The Bankruptcy Code abrogates contractual restrictions on assignment that would in theory enable Oil Corp to assume and assign the trademark license where it is intended that it will achieve a higher value than if restrictions were enforced. However, one of the exceptions to this rule, namely where substantive non-bankruptcy law (such as intellectual property licensing law) provides that the counterparty cannot be compelled to accept performance from a transferee³⁰, may require Plastic Corp's consent to the proposed transfer. There is some divergence in the courts as to whether this prohibition applies to where there is an assumption (applying the hypothetical test³¹) or only when there is to be an assignment of the contract (the actual test). In this case where the election is to assume and assign, the consent of Plastic Corp may well be required either on terms as per the pre-petition contract and / or in accordance with any applicable intellectual property laws.

As with the assumption and assignment of the trademark license, the election to reject the patent licenses so that the purchaser has exclusivity over use of patents must be based on the business judgment of Oil Corp such that it will facilitate payment to creditors. The court will not deny approval of the rejection where the decision is made in good faith or is a reasonable exercise of business judgment. However, the effect of the rejection is that Oil Corp will be deemed to have breached the license agreement in respect of the patents to which Plastic Corp is party to immediately before the petition date. This does not void the contract, therefore Oil Corp and Plastic Corp can retain whatever they have received pursuant to the contract pre-petition. However, the effect of the rejection is that Oil Corp is deemed to have breached the license agreement providing Plastic Corp with an unsecured pre-petition claim in damages³². Notwithstanding this remedy, as section 365(n) of the Bankruptcy Code affords protection of licensee's rights such that they cannot be terminated in connection with the sale of the intellectual property to a third party without such consent. Accordingly, the consent of Plastic Corp is required if Oil Corp wishes to effect a sale of exclusive patent rights to a third party.

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

Commented [H(60)]: Incorrect, consent is required only because of substantive law, not the contract terms

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

Commented [H(62)]: Correct, 1 mark

²⁹ 11 USC, s 365(f)

³⁰ Idem, section 365(c)

³¹ A debtor may not assume an executory contract that it would not be permitted to assign

³² 11 USC, section 365(g)(1)

Although the consent of USA Bank is (at least on the basis of the information provided) not required for Oil Corp's proposals regarding the executory contracts in relation to the trademark and patent licenses, because for the most part Oil Corp will be able to deal with its property in the ordinary course of business without court approval or creditor interference, the situation is different and more nuanced in relation Oil Corp's proposal to sell the manufacturing facility free and clear of USA Bank's lien. Subject to section 363(f) of the Bankruptcy Code provides that an asset may be sold free and clear of creditor interests with creditor consent where the creditor interest is disputed or where the value of the property exceeds the value of the interest. Therefore, if either of these situations apply here (which is not clear from the information provided), USA Bank's interest will attach to the proceeds of the sale and its consent is required.

Commented [H(63)]: Correct, 1 mark

Commented [H(64)]: Partially correct, 1/2 mark. Its interest will attach to the proceeds and its consent is not required.

The proposed sale is not likely to be considered a transaction in the ordinary course of business³³ as it is a sale of property which is unlikely to form part of the routine business conducted by businesses similar to Oil Corp. Therefore, as a non-ordinary course of business transaction, Oil Corp will have to establish that it is proposing the sale in its business judgment (in connection with which it owes fiduciary duties to consider the interests of creditors) and that the transaction is in the best interests of the estate as a whole. USA Bank may elect to "credit bid"³⁴ by offsetting a portion of the purchase price of the manufacturing premises against the amount of its claim secured by the property. For example, it may bid US\$600 million to purchase the manufacturing premises but only pay \$100 million to the estate by, offsetting against the balance of the purchase price against the \$500 million loan advanced to Oil Corp.

*** End of Assessment ***

³³ See *In re Dant & Russell, Inc.*, 853 F.2d 700 (9th Cir 1988) for the two prong test that considers the "vertical dimension" (the expectation of a hypothetical creditor of the debtor) and the "horizontal dimension" (how business is conducted by other businesses similar to the debtor)

³⁴ 11 USC, section 363(k)