



**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 42/50

**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**

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)]: 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**

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**

Commented [H(9)]: 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(10)]: 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(11)]: 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(12):** Incorrect, the correct response is (e)

**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 Proceeding can be commenced by the debtor under any chapter through filing of a petition with the schedules required by the Federal Rules of Bankruptcy Procedure. Even without the schedules (a so called "naked Petition") the stay will come into force and a case commence under the Bankruptcy Code. The form of admission of a Voluntary Proceeding for a corporate entity is short with a requirement to disclose funds on hand, number of creditors, assets and liabilities and there is no need for an insolvency statement.

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

Involuntary proceedings take place under Chapters 7 or 11 of the Bankruptcy Code and cannot be commenced under the chapters nor against farmers, family farmers or non-profits. The number of petition creditors depends on creditors the entity has. The creditors must qualify as petitioning creditors. The petitioning creditors must allege the debtor is generally not paying its debts when due or that, within 120 days prior to petition, a custodian was appointed and took possession of the property of the debtor.

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

A debtor who is subject to an involuntary proceeding remains in control of its business and may operate in the ordinary course. A debtor subject to an involuntary petition may contest the petition on the grounds that the petitioning creditors did not meet the requirements for a petition.

**Question 2.2 (2 marks)**

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

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

Two potential consequences are:

1 – the act undertaken in contravention of the stay is void or voidable (the distinction being one depending on which Circuit you are seeking relief in)

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

2 – the act undertaken may constitute contempt of court which can include fines to be paid to court, payment of the debtors costs and fees in challenging the contravention and requirements to undo the contravening actions.

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

**Question 2.3 (3 marks)**

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

A class is impaired unless it is left after the plan is implemented in the same position as to its legal, equitable and contractual rights as it was prior to the plan. There is an exception to this rule in the case of a class where the plan results in a curing of monetary defaults and compensation to the creditor, in this case even though there has been an altering of the creditors legal position that class will be considered unimpaired. This latter class of creditors whose legal rights are changed but economic position remedied by the plan are not entitled to vote on the plan, they are deemed unimpaired for voting purposes. A holder of an impaired claim who is an 'insider' does not count towards the voting for a class. If the insider forms a class on its own the class is not counted towards approval of a plan.

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

Commented [H(22)]: An impaired claim that will receive nothing under a plan cannot vote and is deemed to reject the plan.

**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?

A preference

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

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?

A constructive fraudulent conveyance

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?

An actual fraudulent conveyance

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

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

Commented [H(27)]: Total marks 13.5/15

**Question 3.1 (3 marks)**

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

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

Amendments were made to the Bankruptcy Code in 1984 to ensure that the Bankruptcy Courts had jurisdiction to pass final judgments on 'core' proceedings under the Bankruptcy Code (28 USC 157). *Stern v Marshall* was a US Supreme Court case which undermined the 1984 amendments to the Code by holding that a Bankruptcy Court cannot, even in core proceedings, issue final orders that invade the jurisdiction of the federal courts established under Article III of the US Constitution.

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

In these cases parallel proceedings were taking place in the Bankruptcy Court and in state courts, this is permitted on the basis that the first to issue judgement prevails. The Bankruptcy

Court issued judgement first followed by a jury in a state court. The awards went to opposite side of the cases. The Supreme Court ruled in favour of the second in time State Court jury judgement on the basis that the Bankruptcy Court's final order over a state law claim was unconstitutional under Article III of the US Constitution. The jury judgment was therefore conclusive of all the issues.

The undermining of the 'sanctity' of core matters being given final orders by the Bankruptcy Courts undermined the basis on which bankruptcy proceedings had been occurring prior to *Stern*. There have been subsequent developments made with the intention of providing more certainty. In *Exclusive Benefits Agency v Atkinson* the US Supreme Court held that the bankruptcy judges may issue a report and recommendation to a district court for approval. In *Wellness Int'l Network v Sharid* the Supreme Court affirmed that the parties to a matter may consent to the Bankruptcy Court issuing final orders. This has been aided by amendment to the Bankruptcy Rules which now require that litigants state in their pleadings whether they consent to the entry of final orders by the bankruptcy court. The Bankruptcy Rules also allow a district court to treat a bankruptcy court order as a proposed finding of fact and conclusion of law.

Commented [H(31)]: Correct, 1/2 mark, a bankruptcy court may also enter a final order on a challenge to a petition

### Question 3.2 (3 marks)

Commented [H(32)]: Total marks 3/3

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?

When adopting the UNCITRAL Model Law on Cross Border Recognition of Insolvency Proceedings as Chapter 15 of the US Bankruptcy Code the US legislature opted, under Article 23 of the Model Law, not to include avoidance provisions. In fact Chapter 15 was adopted to specifically exclude relief available under sections 522, 544, 545, 547, 548, 550 and 724(a). In *re Condor Ins Ltd* this was been interpreted to apply to the use of the avoidance of preferences and fraudulent conveyances but not to bar a foreign insolvency representative to use other applicable US or foreign law to avoid pre-petition transactions.

Commented [H(33)]: Correct, 1 mark

Commented [H(34)]: Correct, 1 mark

Access to the avoidance sections of the Bankruptcy Code can be had by a foreign representative in a plenary proceeding under Chapters 7 or 11. This may be the case where such proceeding has been commenced by someone other than the foreign representative but could also be the case where the foreign representative starts a proceedings under Chs 7 or 11 over US situate assets. Any such proceeding would be coordinated with the foreign proceedings. In addition the foreign representative also has the option to seek relief under applicable foreign laws which deal with such avoidance powers and then seek recognition of those foreign proceedings under Ch 15 proceedings in the US.

Commented [H(35)]: Correct, 1 mark

### Question 3.3 (4 marks)

Commented [H(36)]: 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?

An interlocutory order is an order under which not all the issues or claims are dealt with. A final order is one where all issues are dealt with in the order and there is no further issue at stake in the case. An interlocutory order may only be appealed with the leave of the relevant appellate courts where a final order is automatically eligible for appeal. In *Bullard v Blue Hills Bank* the US Supreme Court held that a bankruptcy order resolving a discrete dispute is a final order for considering whether it may be subject to appeal.

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

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

Commented [H(40)]: Correct, 1/2 mark



Appeals from the bankruptcy courts are either heard in the district court for the district the bankruptcy courts sits in or, if they are formed in the circuit in which the bankruptcy court has handed down judgement, a Bankruptcy Appellate Panel (BAP) for that district. Notwithstanding that there may be a BAP for a district parties may always elect to be heard by the district court instead of the BAP. From the district court or BAP a further appeal of right can be made to the circuit court of appeals. Three are unusual circumstances under 28 USC 158(d) where appeal may go directly from the bankruptcy court to the relevant court of appeals.

The standard of review depends on whether it is a core proceeding or non-core. If it is a core proceeding the relevant appeals forum looks at the findings of law afresh and reviews findings of fact or any wrongly applied discretion. If it was non-core then all findings of law or fact that are being appealed are reviewed afresh.

The appeal removes the right of the relevant bankruptcy court from reviewing its own decision but does not stay the effects of the decision. It is possible to apply to the bankruptcy court (or, due to delay, the appellate court) for a stay of the effects of the underlying appealed judgment. A stay will only be granted where the applicant can show that it would suffer genuine harm with will occur prior to the appeal and would be irreparable.

#### 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?

In Delaware directors owe a fiduciary duty of 'loyalty to the corporation's best interest' and they owe a 'duty of care to be exercised in their decision making'. They are protected in their actions by the 'business judgement rule' where the board of directors is assumed to have acted in good faith and on the basis of reasonable information. This 'business judgement rule' will shelter the directors from liability for anything (other than gross negligence) unless an interested party is able to rebut the presumption that they have acted in good faith or without a basis in reasonable information. The proving of 'bad faith' on the part of someone else is difficult as it requires clear evidence of intention on the part of another and generally evidence of the intention of another is hard to establish. Furthermore it is also possible in Delaware for a corporation to further shelter its directors from liability for breach of duty of care by limiting any such liability in the certificate of incorporation for that corporate body (Del Gen Corp L, 102(b)(7))

The 'business judgement rule' will not have application where the majority of the board has an interest in the transaction and a shareholder (independent or connected) is on both sides of the transaction. In that case the test is whether the 'entire fairness standard' is met otherwise the relevant transaction would be void. The entire fairness standard is a heightened standard to the business judgement rule requiring that the board of directors show that they have conducted a thorough process to determine that the transaction comprised both a 'fair price' and a 'fair dealing'.

The duties of a corporate entity registered in Delaware are in marked contrast to the UK common law derived countries where the board, generally, owes a clear duty to act in the best interest of the corporation's shareholders whilst it is solvent. Once a corporate is insolvent (the precise test being one set out in the relevant jurisdiction but generally is a balance sheet or cash flow test or both) then the board owes its duties to the creditors and no longer the shareholders. In many English law derived jurisdictions, this is then over laid with laws which prevent insolvent or wrongful trading'. These laws generally give rise to personal liability for those directors which breach the relevant rule by trading whilst insolvent. Clearly this is a significant difference to the Delaware position where director liability is much more shielded in an insolvency position; see *Trenwick Am Litig Trust v Ernst & Young LLP*.

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

Commented [H(43)]: Total marks 4/5

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

Commented [H(45)]: Correct, 1 mark, also the duties are owed to the shareholders

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

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

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

Commented [H(48)]: Total marks 14.5/15

**Question 4.1 [4 marks]**

Commented [H(49)]: Total marks 4/4

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 of the Bankruptcy Code incorporates into US law the UNCITRAL Model Law on Recognition of Foreign Insolvency proceedings. It is the section of the Bankruptcy Code under which a foreign representative may seek recognition of those foreign proceedings. Looking at the elements to qualify under Chapter 15:

- The filing for recognition must be made by the foreign representative ('FR') of the insolvent debtor
- The FR needs to show that a foreign insolvency court or tribunal proceeding is on foot in respect to the debtor; a foreign proceeding will come within Chapter 15 if it is 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' (11 USC 101(23))
- The FR needs to show it is empowered by that foreign proceeding
- The proceeding must not be manifestly contrary to US public policy

An English Scheme of Arrangement has been held to qualify under Ch 15 and there is nothing in the fact pattern above to think this would be different and nothing to suggest the narrowly held public policy exception would apply.

Having qualified as recognisable under Ch 15 the US court must characterise the foreign proceeding as a 'foreign main' or 'foreign non-main' proceeding. This characterisation gives rise to the relief available.

Foreign main proceedings are proceedings taking place in the location of the debtors 'centre of main interests' (its 'COMI'). A debtor's COMI is rebuttably presumed to be its place of incorporation. It is the place where third parties can readily ascertain that the debtor's main place of business and management takes place. The test is an objective test and factors such as the whereabouts of head office, management, principal assets, a majority of creditors or the law governing most of its disputes.

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

The connection to England and Wales appears from the fact pattern to be the governing law of the bonds, whilst this is a factor to be considered it does not look to be sufficient to displace the presumption of the place of incorporation (Greece) which also is its principal place of business. Clearly a much more detailed analysis would be required to finally determine this issue.

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

If proceedings are started in a jurisdiction other than that where the debtors COMI is located then it is possible to seek Ch 15 recognition provided that the debtor has an 'establishment' in that location. An establishment is found where the debtor carries out 'non-transitory' economic activity. From the fact pattern the debtor owns and operates a casino or betting parlour in London so it would appear to qualify as having an establishment.

Commented [H(52)]: Correct, 1 mark, this would be recognition as foreign non-main proceedings

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

On recognition of a non-main proceedings the US courts have a number of discretionary reliefs that they may grant but there is no automatic relief. Any relief is with respect to the debtors property within the territorial jurisdiction of the US. It may grant a stay in relation to the assets, permit the FR to operate the debtor's business in the US, approve a sale transfer or use of the debtor's property which is outside of the ordinary course, avoid post-petition transfers and post-petition perfection of security, authorise discovery against the debtor's assets, extend provisional relief and 'any other relief necessary to effectuate the purposes of Ch 15 and protect the assets of the debtor or interests of its creditors'. In the case of non-main proceedings, the US court must be satisfied that any relief is appropriate under US law for the assets in the US to be administered in the foreign non-main proceeding.

#### Question 4.2 [5 marks]

Commented [H(54): 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?

Upon filing of a plenary bankruptcy proceedings including under Ch 11, an 'estate' is created on the 'petition date' of all the debtors assets and interests in relation to which an automatic stay on enforcement arises at that date. USC 11 362(a) specifically sets out a set of prohibitions on post stay actions. Turning to the issues set out in the fact scenario:

Commented [H(55): Correct, 1 mark

#### Texas State Court suit

Any litigation against the estate is stayed on the petition date.

Commented [H(56): Correct, 1 mark

#### Breach of US Sanctions law

Regulatory and criminal investigations are exempt from the stay under USC 11 362(b) so these will continue.

Commented [H(57): Correct, 1 mark

#### Foreclosure over Philippines refinery by USA Bank

The US stay applies globally to all assets of the debtor wherever situate. Any action abroad against the assets would give rise to contempt proceedings and therefore, as a practical matter, would only be taken by someone who would not come within the practical jurisdiction of the US court system. In this case that is unlikely to be the case for 'USA Bank' so I would think that it would stay its enforcement action in the Philippines to avoid any contempt issues.

Commented [H(58): Correct, 1 mark

#### Houston landlord eviction

The stay prohibits any act to obtain possession or control of the property of the debtors estate. The unpaid rent will be a pre-petition claim on the estate. This lease is an executory contract and therefore the debtor will, prior to filing the Ch 11 plan, have to affirm, reject or assign the lease. Continued occupation will be affirmation by conduct.

Commented [H(59): Correct, 1 mark

#### Question 4.3 [6 marks]

Commented [H(60): Total marks 5.5/6

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 "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?

A debtor in Ch 11 may deal with its assets in the ordinary course of its business without the need to get court approvals. Ordinary course sales have been examined by the Courts as the test is not contained within the Bankruptcy Code. The courts have come up with a double test looking at the 'vertical dimension' and the 'horizontal dimension'. The proposed sale of the plastics manufacturing business is unlikely to be an 'ordinary course' sale and therefore a section 363 sale is required. A s 363 sale has the advantage of being court approved and free of any creditor interests. A creditor approval is not required where the creditor interest is disputed or the value of the asset exceeds the creditor's claim on the asset (the claim overreaching into the cash proceeds). Any purchaser under a s.363 sale is entitled to take the property free and clear without any possibility of an unwind even where the court approval is subsequently appealed and reversed.

A debtor has the power during a Ch 11 proceeding to 'assume', 'reject' or 'assign' an 'executory contract'. An executory contract is a contract on both sides of which there are unperformed obligations. For example a lease of property has the unperformed obligations to make the space available to the tenant and the obligation to pay rent to the landlord by the tenant.

In Ch 11 the decision by the debtor whether to reject/assume/assign and assign must be made prior to the confirmation of the Ch 11 reorganisation plan except in the case of real (non-residential) property where it must be made within 120 days of the order for relief.

The debtor must use its judgment in good faith and using reasonable business judgement when making its choices about what to do in relation to a contract. The choice must facilitate a restructuring of the debtor in the case of Ch 11.

Rejection of the contract – this gives rise to the contract being deemed breached just prior to the petition date and therefore a pre-petition unsecured claim for damages for the creditor.

Assumption of the contract – to assume the debtor must cure any defaults and provide assurance of its good performance in the future.

Assume and assign – this allows the debtor to transfer its rights under the contract to a third party who gives the counterparty adequate assurance of future good performance. This is of most use where Ch 11 is being used to facilitate a pre-pack into a new vehicle. Any contractual prohibitions on assignment are over ridden under Ch 11 unless it is a loan contract or where Bankruptcy law prohibits overriding of consent requirements.

I note that OilCorp is incorporated in Delaware which falls in to the 3<sup>rd</sup> circuit of appeals. Courts in the Third Circuit apply the 'hypothetical test' when considering assumption of contracts by the debtor. A debtor can only assume a contract in the Third circuit (and fourth, ninth and eleventh circuits) if there is no prohibition on assignment. In other words they cannot assume a contract where there is a prohibition on assignment. Whether this is relevant will depend on where the Ch 11 is filed and OilCorp has a number of options as venue is proper in courts where a range of business activities takes place and is not tied to incorporation per se. If the

petition was filed in Texas (as OilCorps main place of business that would be a proper venue) then the hypothetical test would not apply and prohibitions on assignment are only relevant in the case of affirmation and assignment.

Looking at the questions in turn

- (i) *Can it assume and assign the trademark licence:*  
A licence is an executory contract in that the licence requires the grantor to give the grantee a use in return for an ongoing payment. On both sides there should be unfulfilled obligations. The only exception would be where the licence was given for a lump sum and specified term where no further requirements on behalf of the transferee remain to be performed. If it is an executory contract, assignment to a third party depends on where the court with supervision of the Ch 11 is situate as explained above. Generally trademark licences cannot be assigned without consent. Whether the consent will be overridden by Ch 11 will depend on the nature of the asset, generally intellectual property rights are not overridden by Ch 11 because they are protected by non-Bankruptcy IP law. Therefore, if protected by non-bankruptcy IP law, it is unlikely that OilCorp will be able to assume and assign the licence without PlasticCorp's consent. If it is not protected by substantive non-Bankruptcy law then OilCorp needs to show that its assumption and assignment is based on the best business judgement of OilCorp made in good faith and in the reasonable exercise of judgement of the management of OilCorp.
- (ii) *Can it reject the patent licences so the purchaser [of the plastics business] has the exclusive right to use the patents:*  
Patent licences have a similar performance pattern to the trade mark licences mentioned above and therefore are likely to have unperformed obligations on both sides making them executory. A licence is granted by the debtor is protected under 11 USC s. 365(n) without the consent of the licensee. In this case any sale by OilCorp would require the consent of PlasticCorp.
- (iii) *Sell the manufacturing facility free and clear of the USA Bank lien:*  
A debtor can sell its assets free and clear of creditor interests with court approval in a s. 363 Sale (see 11 USC s.363(f)) where the creditor has consented, where the sale price of the asset exceeds the secured debt or where the creditors interest in the asset is disputed. In this situation USA Bank's consent will be required unless the price being paid for the refinery exceeds the bank debt, in that case the sale may proceed and the relevant part of the proceeds will be applied to USA Bank to discharge its debt.

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

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

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

Commented [H(64)]: Partially correct, 1/2 mark, Oil Corp can sell without Plastic Corp's consent, but cannot grant exclusivity to the purchaser because of Plastic Corp's license

Commented [H(65)]: Correct, 1 mark

Commented [H(66)]: Correct, 1 mark

**\* End of Assessment \***