



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 43.5/50

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): Incorrect, the correct response is (c)

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)]: Correct, 1 mark

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)]: Correct, 1 mark

QUESTION 2 (direct questions) [10 marks]

Commented [H(13)]: Total marks 8/10

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?

Voluntary Bankruptcy proceedings are where a debtor applies to make themselves bankrupt. The debtor must file a list of debtors and creditors. A 'naked' petition, which contains no lists is sufficient to commence an automatic stay and proceedings.

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

However, Involuntary Bankruptcy proceedings are where a creditor petitions for the bankruptcy of the debtor, under chapter 7 or 11. If there are less than 12 creditors, only one must petition, however if there are more than 12 creditors, then at least 3 must petition.

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

A voluntary petition also does not require the assertion that the debtor is insolvent. However, for involuntary proceedings, the creditor must show that:

- The debtor cannot pay their debts as and when they fall due
- That a custodian has been appointed in the 120 days prior to filing

Question 2.2 (2 marks)

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

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

Any acts undertaken that violate an automatic stay is in contempt of court.

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

The act in breach of the stay may then be void or voidable. This depends on which circuit the proceedings are pending in. There may also be a daily fine issued against the violating party, which would be paid to the Court.

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

There may also be the requirement to pay debtor's legal costs incurred in relation to rectifying or as a result of the violation. The debtor also has the ability to commence a lawsuit against the violator. In addition, the party committing the act may also be ordered to undo any affects as a result of the violation.

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?

s1123 and s1124 of the Bankruptcy Code states that an impaired claim is a claim where their contractual rights must be modified or not paid the full value of their claim.

It will allow a creditor to have secured and unsecured claims, when the Plan may change the contractual, equitable and legal right which a creditor may claim under.

Impaired classes of creditors, are creditors which are expect to accept less than they are owed. Where a debtor is reorganised, there will be a combination of impaired and unimpaired claims.

Any plan for reorganisation is voted on by creditors and then approved by the relevant court. Usually, only impaired creditors have the ability to vote on a plan.

Insiders voting on a Plan will not be counted. Two thirds of the remaining creditors, by value of their claim, must vote to accept it. The holder of an impaired claim can challenge the Plan if it has been treated unfairly.

However, a plan can be crammed down to mitigate any issues with holdout. A plan can use cramdown to any impaired creditors which dissent. To comply, all the necessary requirements should be met and one other impaired creditor must have voted to accept the plan.

The plan must also be fair to and not discriminate against any creditors that do not consent and act in good faith.

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

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

Commented [H(22)]: An impaired class that will receive nothing under the 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?

Preferences

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?

Preferences

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

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

Actual fraudulent conveyance

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

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

Commented [H(27)]: Total marks 14.5/15

Question 3.1 (3 marks)

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

During 2011, the US Supreme Court held that the Bankruptcy court could not issue Final Orders in contravention of Article III jurisdiction, even in core proceedings.

In the circumstances, the Bankruptcy claim which was filed, had been counterclaimed by the debtor. Simultaneously, the counterclaim became involved in court proceedings in a different state.

Whilst it is possible to have simultaneous proceedings in federal and state courts, the first judgement should be binding on those parties involved. However, in these circumstances, the Bankruptcy court made findings in the first instance, however the case continued in the state courts, despite the findings being subject to appeal.

The outcome in the proceedings in the State court reaffirmed the Judgement in the district courts.

28 USC s157 states that any counterclaims form part of the core proceedings, in which a Bankruptcy court has the ability to award a Final Order. However, the Supreme Court decided that a Final Order being issued in respect of a state claim was in contravention of Article III. As a result, the verdict was conclusive in the first Judgment.

New amendments and rulings in the Bankruptcy Rules have given more guidance subsequently. Now, a district court has the sole jurisdiction in Bankruptcy proceedings, in relation to adjudicating a petition. The Bankruptcy court does have the abilities to delegate to a District court to make a Final Order, where the validity has been challenged.

The Supreme Court concluded that a judge does have the ability to aware in core proceedings, even if they do not have the necessary authority. This must be done by giving written recommendations in a report to the District court. This is, in essence, a similar procedure to none core proceedings, which all Final Orders can be made with the consent of parties.

The Bankruptcy Riles have further reiterated this, by causing litigants to confirm in their proceedings whether they consent to Final Orders in the Bankruptcy Court. As a result, by giving a District court this authority, the Bankruptcy court will not have the ability to make any Final Orders or to treat any orders as findings of fact.

This made vary depending on whether an order becomes final, for the purposes of an appeal.

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?

In the Model Law, Article 23 defines the powers available to Foreign Representatives, once they have obtain recognition within a foreign proceedings. This relates to any acts which may be detrimental to creditors.

S101(24) of the Bankruptcy Code defines a foreign representative.

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

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

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

Commented [H(31)]: Partially correct, 1/2 mark, the district court is the one delegating its authority to the bankruptcy court so the bankruptcy court can enter the final order

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

Commented [H(33)]: Total marks 3/3

Whilst the Model Law does not state which specific powers are available, it provides text in brackets, which states that the enacting legislation should *refer to the types of actions to avoid or otherwise render ineffective acts detrimental to creditors that are available in this State to a person or body administering a reorganisation or liquidation.*

This implies that the actions which are available to a foreign representative are the same as those provided to a trustee or domestic debtor. Whilst Chapter 15 is similar to Model Law in many ways, it excludes the ability for foreign representatives to use any avoidance power given in the Bankruptcy Code.

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

It has been viewed that this only applies to the Bankruptcy Code in respect fraudulent conveyances and preferences, rather than looking to avoid pre petition transactions. This is also reaffirmed by s204 of the Bankruptcy Code.

Commented [H(35)]: Not quite sure what you are saying here because preferences and fraudulent conveyances are categories of pre-petition transactions that can be avoided

In addition, under the Bankruptcy Code, avoidance powers are not available to foreign representatives. They are excluded pursuant to 11 USC s1523. The interpretation has been that foreign representatives are unable to pursue fraudulent conveyance transactions and preferences.

A foreign representative can still use avoidance powers under the Bankruptcy Code, in plenary proceedings in Chapter 11 or 7. In these proceedings, where started by the debtor/creditor before the appointment of a foreign representative, the foreign representative can elect to begin plenary proceedings under the Bankruptcy Code after recognition under Chapter 15. These proceedings would be limited to US assets and co-ordinated by the foreign proceedings.

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

A foreign representative also has the ability to start their own plenary proceedings. This would provide access to the avoiding powers (if the relief is unsatisfactory under the applicable law), under the Bankruptcy Code. This may be used when an applicable law does not provide for constructive fraudulent conveyance or has expired under the statute of limitations.

Furthermore, relief can be sought to unwind transactions prior to the petition, using other US legislation or the legislation of the appointing country.

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

Question 3.3 (4 marks)

Commented [H(38)]: 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?

The difference between interlocutory orders and final orders is defined in the US non-bankruptcy procedures.

Final Orders will dispose on all the issues in the proceedings, which no further matters to be decided on. Interlocutory Orders will only deal with certain elements or issues, in wider proceedings.

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

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

Final Orders have a right to be appealed. However, leave of the appellate court must be given to appeal an interlocutory order.

Commented [H(41)]: Correct, 1/2 mark

Commented [H(42)]: Correct, 1/2 mark

This framework also applies to Bankruptcy proceedings, apart from that the period of extension to propose a Plan has a right of appeal.

The difference between the orders can become difficult when the court deals with issues that are more broadly applicable (e.g. an interest rate post petition), rather than a simple claim.

The Supreme Court did find that a minor dispute was a final order, in a Bankruptcy claim, and could not be appealed.

Appeals which are decisions from the Bankruptcy Court will be decided by the respective district court, where the claim sat.

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

In some places, any bankruptcy appeals will be referred to the Bankruptcy Appellate Panel, made up of various judges who sit in the bankruptcy courts. In these circumstances, a party can request for a matter to be heard by a district court, alternatively.

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

Occasionally, the bankruptcy court may refer directly to the court of appeal. This is only where an appeal is in relation to law which does not fall under the control of the Supreme Court or where a claim may be advanced significantly if the appeal is immediately appealed.

It is for the court of appeal to decide where it will accept as matter.

Question 3.4 (5 marks)

Commented [H(45)]: Total marks 5/5

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?

The liability of Executive Officers, Directors and Controlling Shareholders in the US is more limited than most other jurisdictions. Specifically in Delaware, a director owes a fiduciary duty:

- Act in the best interest of the company
- Hold a duty of educated decision making
- Protection from liability, under the business judgement rule, for errors of judgement

This can be described from a basic perspective as care, loyalty, good faith, oversight and disclosure duties.

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

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

Commented [H(48)]: These are subsumed within the duties of care and loyalty

The business judgement rule assumes that reasonable information has been used in good faith by a board of directors. This can be rebutted where a majority of directors had not been reasonably informed and believed their actions were in good faith and honestly in a company's best interests.

Assuming there is no rebuttal, a director would not be held liable, unless gross negligence has been found. A certificate of incorporation may exclude a director from a liability for breaching their duty of care, but not loyalty.

Where a transaction has been granted by a majority of the directors, which are not independent, the business judgement rule will not apply. As such, unless the entire fairness standards are complied with, the transaction will be classed as void.

A director's duties are owed to the company and the shareholders of that company. Even when a company is likely to be insolvent and the shareholders would not receive any return in the insolvency proceedings, the duty continues to be to the shareholders not the creditors of the company.

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

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

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

In the matter of *North AM Catholic Educational Programming Foundation Inc v Gheewalla*, the Delaware Supreme Court held that there is no duty to creditors when the company is either insolvent or potentially insolvent.

The matter of *Trenwick Am Litig v Ernst & Young LLP* then concluded that as a result, a director could not be liable for deepening insolvency or wrongful trading under the US legislation.

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

Commented [H(52)]: Total marks 12/15

Question 4.1 [4 marks]

Commented [H(53)]: Total marks 3/4

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.

In order to meet the requirements for recognition, a foreign representative must show that foreign court proceedings are ongoing, in which a foreign representative is empowered to act in.

The foreign proceedings will not need to be similar to a US bankruptcy case in order to be recognised. The Bankruptcy Code defines a foreign proceeding as a *collective judicial or administrative proceeding in a foreign country* and further states that *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*.

As such, in these circumstances, given that Gambling Corporation operates casinos and betting parlours in Las Vegas, it is possible that an English Scheme of Arrangement could be granted under Chapter 15.

There is a possibility that the proceedings could be refused recognition if it was against public policy in the US, however this exception is not often met and is very limited.

In order to define between foreign main proceedings and foreign non-main proceedings, the company's centre of main interests needs to be decided. To be a foreign main proceeding, the debtor must have established in the same jurisdiction as the proceedings are brought.

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

A debtor's COMI would usually be the place in which it's incorporated. However, factors to consider include the location of primary assets, management, headquarters and creditors.

If the proceedings are in a jurisdiction where a debtor has an establishment, but is not its COMI, then this would give rise to non-main foreign proceedings. An establishment is defined under 11 USC s1516(c), an establishment is a jurisdiction where non-transitory economic activity was carried out, prior to Chapter 15 proceedings being commenced.

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

As a result of the operating casinos and betting parlors, the Gambling Corporation would have had an establishment in the US, but not a COMI. The COMI would most likely have been in

Commented [H(56)]: Incorrect, for foreign non-main recognition, there needs to be an establishment in the jurisdiction where the foreign proceedings are pending. Here, the London casino qualifies so foreign non-main recognition is appropriate.

the Greece as it is incorporated there and has its placed of business there. As a result, there recognition under Chapter 15 would be foreign non-main proceedings.

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

If this is the case, then the US recognition would limit what relief is available, and will be at the discretion of the court. The foreign representative would need to show that there are the appropriate circumstances for the assets to be included in the English scheme, to the court.

Question 4.2 [5 marks]

Commented [H(58)]: 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?

When filing for Chapter 11 bankruptcy, a company will retain control and supervision of all assets. In addition, it will suspend any collection activity, foreclosure, judgement or repossession against the company.

It will also have a worldwide stay, giving 120 days to create and negotiate a restructuring plan with its creditors. For any breaches of this stay, the party in violation will be in contempt of court.

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

Breach of contract

In the event of a breach of contract, ShipCo would have a claim as a creditor in the proceedings. However, as a petition has not been presented, the proceedings will be stayed. Oil Corp should give notice to the court and any parties to the claim.

Commented [H(60)]: Correct, 1 mark, assuming you mean "now" instead of "not"

However, in order to quantify their claim, they would need to obtain a judgment against Oil Corporation. The moratorium over Oil Corporation suspends any judgments being made against the company.

In the circumstances, the claim may be reviewed and considered, with a reasonable sum agreed to mitigate costs being incurred by the debtor in possession.

DOJ reviewing illegal purchase

The debtor in possession has the ability to pursue claims for fraudulent transfer. The proceeds can increase the value of the estate for the benefit or creditors.

Commented [H(61)]: Transactions in violation of sanctions are illegal, but probably not fraudulent conveyances, assuming that assets were sold for fair value.

The debtor in possession will likely want to work alongside the DOJ to obtain their records and information. There then may be the ability to work together on the dispute, to obtain a recovery, for the benefit of creditors.

In the circumstances, the directors of Oil Corporation could be pursued, as this may be in breach of their fiduciary duties. By entering into contracts with countries subject to sanctions, they were not acting loyally or in the best interest of the company. As a result, the Directors may be personally liable for the losses incurred.

The DOJ could also continue their proceedings as it is a regulatory investigation.

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

Secured Loan

Chapter 11 proceedings are a plan of reorganisation which is approved by the court, without requiring the approval of all creditors classes, known as a cramdown. Cramdown is when a plan is approved by an impaired creditor, being a creditor, which is not receiving 100% of their claim (and is no worse off than in Chapter 7).

During the proceed, a debtor has the ability to force secured creditors to alert the terms of the debt. Therefore, the Oil Corporation will have the ability to alter the terms of the debt under Chapter 11 proceedings. If the bank is being paid in full and an impaired creditor agrees to the proceedings, then the bank will be bound by the proceedings.

In addition, Oil Corporation will have the protection of the Chapter 11 moratorium. As such it will not be able to foreclose on the refinery in the Philippines, which will remain operational.

If there was no equity in the refinery and there is no requirement under the Plan, the Bank could apply to lift the stay. The Bank could also apply if the aim was to defraud creditors.

Rent Arrears

As such, this will restrict the Landlord from evicting Oil Corporation from its premises. The director should ensure that a copy of the petition and order are filed on the landlord, so that sufficient notice is received.

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

In addition, it is noted that Oil Corporation only forgot to pay it's rent, rather than being unable to do so. Therefore, it would be best placed to make the landlord aware that it was an error and that payment will be made urgently. This should reduce the pressure from creditors. The premises is likely critical for the trade of the company, so it would be unlikely to be considered as a preferential payment.

Chapter 11 also provides Oil Corporation with the ability to reject any contracts which are considered a burden. Therefore, any contracts with the landlord may be removed or rejected.

Question 4.3 [6 marks]

Commented [H(64)]: Total marks 4/6

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

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

Under the Bankruptcy Code, s363 is a provision that allows for the sale of assets outside the course of business and clear of liens. It is automatically application in foreign proceedings which have been recognised and foreign non-main proceedings. Any sale under s363 requires the approval of the court.

The aim is to increase the funds realised for the creditors in the estate and give more protection to any prospective purchasers.

s363 sales provide for the sale of assets clear from creditors interests. As such, the lien of 500m held by the Bank will not be transferred with the business. In addition, the Chapter 11 moratorium will stop the loan from becoming enforceable.

The contracts in this example are all executory contracts.

Goal (i) – Assign trademark

Oil Corp would need the consent of Plastic Corp to assume and assign the trademark. Under federal law, trademark licences are not assignable without the licensor.

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

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

This contradicts most executory contracts, which have the ability to be assigned without the consent of the counter party in bankruptcy, pursuant to the Bankruptcy Code.

Goal (ii) – Reject patent licence

Depending on the bankruptcy process being used, Oil Corp can reject the patent licence, without the consent of Plastic Corp.

Pursuant to chapter 11, the licence cannot be rejected, if the purpose is for it to be sold to another party. However, permission could be requested from the Court to terminate.

However, in accordance with chapter 7 proceedings, Oil Corp could reject the licence outright. This will happen automatically if no action is made within 60 days of the petition. In this event, Plastic Corp could claim for damages against Oil Corp.

Commented [H(67)]: The licensee is protected from termination of the license in either event by section 365(n). Thus, Plastic Corp's consent is required to provide a purchaser of the patent with exclusivity

Goal (iii) – Sell manufacturing facility

The value of the property will be the main factor to dictate whether Oil Corp can sell the facility free and clear of the Bank's lien.

If the value of the secured debt is less than the property, there will be equity. As such, the property can be sold under s363 of the Bankruptcy Code. The Bank would take lien of the sales proceeds, ahead of the other creditors.

Commented [H(68)]: Correct, 1 mark

Commented [H(69)]: Correct, 1 mark

If the value of the debt exceeds the value of the property, Oil Corp will need to seek consent from the Bank to sell the property.

Other considerations

If creditors are not satisfied with the sale, they may object under a sub rosa plan. The plan is not subject to the requirements or protection provided in the Bankruptcy Code. The plan is rather a settlement and de facto plan of reorganisation.

It is only available where the majority of assets are best sold. However, sub rosa plans are rarely successful.

To comply with the s363 process, a robust marketing process must have been undertaken. The prospective purchaser cannot be an affiliate or an insider to the company. The approval of the sale is always subject to court approval.

Given the potential complexity of the issues and the implications, it may be necessary to seek legal advice on these goals and the implementation of the plan.

*** End of Assessment ***