



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 8/10

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

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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

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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

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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]

Question 2.1 (2 marks)

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

A voluntary petition is started by the debtor upon filing a form under the applicable chapter. A voluntary does not need to be or claim to be insolvent.

An involuntary petition is started by a creditor against an eligible debtor under either chapter 7 or chapter 11. An involuntary can only be opened under these two chapters and has exclusions against who can be filed against. The exclusions of the involuntary petitions include farmers, family farmers not for profit organisation. An involuntary may require more than one creditor involved with the petition depending on the number of a specific unrelated creditor type. Has the requirement to allege either that debtor is generally not paying debts as they become due or custodian has taken possession of property of the debtor.

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Commented [H(14)]: Correct, 1 mark

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

Question 2.2 (2 marks)

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

The two potential consequences of a violation of the automatic stay are sanctions for the contempt of court or the action taken is void or voidable. Under the sanctions, it could include having to cover the debtor's lawyer's fees and having to try and undo the action taken to end its contempt.

If the party is seen not to be cooperative, the court can impose daily fines until the action they took is undone.

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Commented [H(18)]: 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?

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A claim is considered to be impaired if the rights to their claim, and all those in the same class have had their legal, equitable and contractual right altered. If those elements remain untouched, then it is an unimpaired claim.

Commented [H(20): Correct, 1 mark, alteration of any of these is sufficient

A holder of an impaired claim is not entitled to vote when a class will receive nothing, they have already been deemed to reject the plan as they are assumed not to vote in favour of the plan if they receive nothing.

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Commented [H(22): Correct, 1 mark

A holder of an impaired claim is also not entitled to vote when they are an insider. In this case two thirds of the remaining arm's length creditors, by value, are required to pass the vote.

Commented [H(23): They can vote but their votes cannot be the impaired accepting class for purposes of cramdown.

Question 2.4 (3 marks)

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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 applied to transfer made on account of antecedent debt.

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(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(26): Correct, 2 mark

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

Actual fraudulent conveyance.

Commented [H(27): Correct, 1 mark

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

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Question 3.1 (3 marks)

Commented [H(29): Total marks 2.5/3

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

Originally, bankruptcy judges could hear and determine only core proceedings. Core proceedings are listed in the US Code and include allowance for claims in an estate, orders in respect of getting credit, determination on proceedings to recover preferences. The Bankruptcy court did not have the authority to make a final determination on the non-core proceedings and submits a proposed findings and conclusion for the district court to decide on.

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In the *Stern v Marshall* case, the court held that even in core proceedings of a counterclaim, a bankruptcy court cannot issue final orders that encroach on Article III jurisdiction, which refers to that of trial level district courts, regional court of appeals and the US Supreme Court.

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In the *Stern v Marshall* case, there were concurrent proceedings in the bankruptcy and state court and was ultimately decided that while the bankruptcy court decision was in appeal that the state court had the first final judgment and the bankruptcy court's decision over a state claim was unconstitutional under Article III. The way the US Supreme Court has since made rulings and amendments, is that if the bankruptcy court lacks constitutional authority, they can

issue a report and recommendation for review by the district court, same as non-core proceedings or with consent of parties can issue final orders.

Commented [H(32)]: Correct, 1/2 mark, they can also enter final orders on a challenge to a petition

Question 3.2 (3 marks)

Commented [H(33)]: 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?

Foreign representatives do not have access to the avoidance provisions, which is interpreted to be for preferences and fraudulent conveyances. It is not meant to extend to the foreign representatives' power to seek to avoid pre-petition transactions under other laws.

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

For the foreign representative to obtain equivalent relief, there are two ways this can be done. The first way is via the debtor itself or its creditors prior to the foreign representative becoming involved. The second way is through understanding that when Chapter 15 was created, it was designed as an ancillary process, which means it was in place to assist foreign proceedings and not for the US to exercise its authority over the entire estate. Chapter 7 and Chapter 11 proceedings are known as plenary proceedings, contain avoidance powers and can be invoked by a foreign representative following the recognition of the foreign proceedings under Chapter 15.

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Question 3.3 (4 marks)

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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?

Final orders are those that deal with all of the issues, leaving nothing further to be decided. Final orders may be appealed as of right. An order that is constitutionally final because the bankruptcy court had authority to enter it is not final for purposes of appeal if it does not resolve the entire issue in dispute.

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

Interlocutory orders resolve only some issues or claims. Interlocutory order can only be appealed with the leave of the appellate court. Orders extending the exclusivity period to propose a plan are appealable as of right.

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

Appeals from bankruptcy court decisions are usually heard by their respective district court while others have formed Bankruptcy Appellate Panel's to hear their decision. The court of appeal will directly hear a bankruptcy court order where either the appeal raises a question of authority to make a decision or is resolving conflicting decisions between the bankruptcy and district court or if the immediate appeal will progress the case substantially.

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

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?

During the ordinary course of business, directors of Delaware corporations owe a fiduciary duty of loyalty to the corporation's best interest and a duty of care in educated decision making. These fiduciary duties are owed to the corporation and its shareholders, not to creditors.

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

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

Commented [H(48)]: Correct, 1 mark

These laws are specific to Delaware because director liability is decided by state law.

The directors are also afforded the protection of the business judgement rule, where the directors can be assumed to have made decision in good faith and with sufficient information to do so. This protects the directors from the liability associated with errors in judgement. It is only when the assumption is argued against successfully where the directors may be liable for acting negligently.

The case of *North Am Catholic Educational Programming Foundation, Inc v Gheewalla*, decided in the Delaware Supreme court, shows that where a company is operating in the zone of insolvency or is insolvent, the Directors do not owe any duties to creditors. As is common in other jurisdictions, the officers of a Delaware company cannot be charged for wrongful trading or deepening insolvency and so when a company is in this position the Directors duties are still owed to the corporation and shareholder.

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Creditors protection or avenue for recovery is the ability to bring a derivative action on behalf of the insolvent company.

The other case of *Trenwick Am Litig v Ernst & Young LLP* reinforced for the Delaware directors that the board may act in good faith strategies to maximise the value of the firm even when insolvent, without the requirement to stop operating and put the company into liquidation.

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.

In 2005, the US adopted the UNCITRAL Model Law on Cross Border Insolvency in full as chapter 15 in the US Bankruptcy Code.

A filing of a foreign representative for the debtor is the only way for a case to be commenced under chapter 15. To be recognised, the foreign representative must establish that a foreign court or administrative proceeding with respect to the debtor is pending and that the foreign representative is empowered to act by the proceeding.

The recognition of a matter by the Bankruptcy code needs to be a foreign proceeding and is defined as "collective judicial or administrative proceeding 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." Under this definition, the foreign proceeding would include the English Scheme of Arrangement. Although unlikely, under US public policy ground, a recognition can still be refused after meeting the definition criteria.

In determining whether the recognition will be granted under foreign main or foreign non-main proceedings, the centre of main interests (COMI) needs to be determined. The difference between the foreign main or foreign non-main proceedings is related to the scope of relief available post recognition.

Commented [H(52): Correct, 1 mark, specifically foreign main proceedings are in the jurisdiction of the COMI and foreign non-main are not in the jurisdiction of COMI but in a jurisdiction where there is an establishment

A debtors COMI is determined usually by where it is domiciled, its principal place of business and location of assets as per the case *Morning Mist Holdings v Kyrs (In Fairfield Sentry Ltd)*. Section 1516(c) of the US code also allows for the registered office to determine the debtors COMI but this can be argued against.

Other factors used to determine the COMI are not available from the facts such as location of management, location of primary assets or location of major creditors.

In this case it is presumed to be its place of incorporation, which is Greece, also noted as its principal place of business. As the COMI is Greece, it therefore cannot be the foreign main proceedings.

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As the company has non-transitory economic activity in Las Vegas, characterised by operating a casino in Las Vegas prior to chapter 15 proceedings, means the establishment criteria to be foreign non-main proceedings is met.

Commented [H(54): Incorrect, the establishment required for foreign non-main recognition must be in the jurisdiction of the foreign proceedings. Here, the London casino would meet the requirement.

From the above, the English scheme of arrangement will be granted recognition under the foreign non-main proceedings.

Question 4.2 [5 marks]

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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?

The effect of Oil Corp filing a Chapter 11 petition, there will be an automatic worldwide stay of any proceeding against the debtor or its property. This gives the company time to prepare the plan of reorganisation resulting in the amendments to creditors debts.

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The impact of each individual situation is outlined below, and the impact determined on each is explained.

Situation One – Breach of Contract lawsuit in Texas for US 1bn in damages by creditor Automatic stay will be enforced as it fits within pre-petition litigation claims. This means that the proceeding will be stayed and held to provide Oil Corp the breathing space to deal with the claim. If any action is taken by Ship Co, it will be a violation of the stay will be contempt of court or a voidable transaction. While an exercise of rights under a commodity contract can be an exception to the automatic stay, the claim is for a breach of contract due to contamination not the ability to exercise its rights.

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Situation Two – Investigation for breaching US sanctions

This item is will not be stayed under the automatic stay as a claim has not been brought at the date of the filing and as the Department of Justice are conducting the investigations, they are specifically excepted from the stay under regulatory investigations. While Directors under Delaware law cannot be pursued for breach of duties if acting in good faith, if they are found to be negligent in their duties they can be liable for their acts.

Commented [H(58)]: Correct, 1 mark

Situation Three – Secured creditor threatens foreclosure for missed payment

Secured creditors are also limited by the automatic stay on the filing of the petition. If USA Bank want to foreclose on the oil refinery, they may apply for to request relief from the stay through a lift stay or relief from stay motion. Depending on the equity position and valuation would determine if the relief from stay was appropriate to be granted. If it was found that the filing was to avoid the secured creditors rights and deal with the property without the proper consent, the bank may also be able to get a relief from stay.

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Situation Four – Texan landlord threatening eviction for rented office space

The facts specify the tenant has forgotten to pay rent and does not mention the rental contract has expired so the automatic stay would apply against the landlord being able to evict them. If the office lease had expired, their would have been an exemption to the automatic stay. If Oil Corporation wished to continue to occupy the premise, it would have to be paid going forward for any use.

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Question 4.3 [6 marks]

Commented [H(61)]: Total marks 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?

While under a 363 sale, where a debtor can sell an asset free and clear, a creditor consent is needed when the creditor interest is disputed, or the asset value is greater than the value of the interest per the US Code section 363(f). In relation to the following goals of Oil Corp:

Commented [H(62)]: This is backwards; creditor consent is not needed in those circumstances and you correctly apply the law below

- I. Assume and assign the trademark license – the trademark license is intellectual property of Plastic Corp and would need the consent of Plastic Corp before assuming it. Per Trump Entertainment Resorts, Inc. 526 BR 11, Federal trademark law generally bans assignment of trademark licenses absent the licensors consent. Oil Corp will not be able to achieve this first goal without consent.
- II. Reject the patent licenses so the purchaser exclusive rights – Under section 365 (n) of the US Code, licensees of patents and copyrights owned by the debtor are protected such that their licenses may not be terminated in connection with the sale of intellectual property without their consent. In this case, Oil Corp would need the consent of Plastic Corp to gain exclusive rights.
- III. Sell the manufacturing facility free and clear of the USA Bank lien – from the facts of the matters, the lien over the manufacturing facility is to secure the USD 500 million loan, making USA Bank a secured creditor with a lien over the asset. Depending on the value of the asset compared to the debt, will determine whether Oil Corp will be

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

able to sell without USA Bank's consent. If the secured debt is more than the value, i.e., no equity held by Oil Corp, then USA Bank will need to provide consent for the sale of the manufacturing facility. If there is equity, then the facility can be sold via a 363 sale. If USA Bank are not provided with an opportunity to give consent, they may be able to get relief from stay to deal with the manufacturing facility.

Commented [H(67)]: Correct, 1 mark, also the lien will attach to the proceeds of the sale

*** End of Assessment ***