



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 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

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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

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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

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Which of the following statements about 363 sales is **false**?

(a) A 363 sale permits a debtor to sell an asset free and clear of encumbrances.

(b) A creditor's lien on assets sold in a 363 sale attaches to the proceeds of the sale.

(c) A 363 sale must be conducted as an auction with a stalking horse bidder.

(d) Purchasers may pay a higher price for assets sold in a 363 sale than in an out-of-court transaction.

(e) Sophisticated parties will insist on a 363 sale if there is any question regarding whether the sale is "in the ordinary course of business".

Question 1.9

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.

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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 for bankruptcy is led by the debtor and can be a proceeding under any applicable chapter of the Bankruptcy Code. The filing of the petition will also invoke an automatic stay.

An involuntary petition for bankruptcy is creditor led and can only be under chapter 7 or chapter 11 of the Bankruptcy Code. There are also restrictions against which debtors a petition can be commenced. There are rules regarding who qualifies as a petitioning creditor and the number of petitioning creditors required. The involuntary petition further requires an allegation of insolvency or steps taken to enforce a lien.

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Question 2.2 (2 marks)

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

A violation of the stay is contempt of court and is void or voidable. If the stay violator does not seek relief for their actions, the Court can impose sanctions. This could include damages, payment of the debtors' attorneys' fees, or being required take steps to undo the impact of their violation.

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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 claim is impaired when the claimant's legal, equitable and/or contract rights are altered. This would include paying less or not deferring payment. For voting purposes, an insider's vote is disregarded. Also, any claims that have are objected to by the debtor and therefore disallowed, cannot vote on the plan. This could be because it is filed after the date or where there is a

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

defence to the claim. Any **impaired claimant** that was not listed in the schedules and did not file a claim will not be entitled to vote.

Commented [H(22): An impaired class that will not receive anything under the plan does not vote and is deemed to reject the plan.

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**.

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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?

A **preference**.

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

Actual fraudulent conveyance.

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

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Question 3.1 (3 marks)

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

Bankruptcy Courts are created by the Bankruptcy Code, rather than Article III of the US Constitution. Jurisdiction over bankruptcy matters sit with district courts under US law, but these cases can be referred to the Bankruptcy Courts. Prior to the case of *Stern v Marshall*, it was considered that the Bankruptcy Court had jurisdiction to enter final orders for 'core' matters as under the Bankruptcy Code. However, the Bankruptcy Courts cannot enter final orders to matter that are 'non-core', **without the consent of the parties**.

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Commented [H(30): Correct, 1/2 mark, also the bankruptcy court can enter final orders on challenges to petitions

In *Stern v Marshall*, a bankruptcy claim was made against a debtor and a counterclaim had also been filed by the debtor. The Supreme Court decided that in accordance with the US Constitution, the Bankruptcy Court was not able to make a final order on the counterclaim because this was a matter reserved for Courts with Article III powers.

Commented [H(31): Partially correct, 1/2 mark, specifically the bankruptcy court cannot enter final orders on core proceedings if they are within Article III jurisdiction

Question 3.2 (3 marks)

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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?

A foreign representative is unable to utilise the avoidance provisions relating to preferences and fraudulent conveyances within the Bankruptcy Code. The foreign representative can utilise these powers in situations where a bankruptcy proceeding was commenced by the

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debtor or creditor, or where the foreign representative commences plenary proceedings after recognition under chapter 15.

Commented [H(34)]: Correct, 1 mark, or the foreign representative may bring claims under analogous foreign or non-bankruptcy US law

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?

In the US, interlocutory orders only resolve some issues relating to the claim, whereas final orders resolve all matters. For interlocutory matters, require the leave of the appellate court to be appealed. Any final orders can always be appealed.

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

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

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

In a bankruptcy context, certain interlocutory type matters can be appealed, i.e. extension of time orders to propose a plan. Orders relating to discrete disputes are considered to be final orders.

Typically, appeals are heard by the relevant district court (which can themselves be appealed to the circuit court of appeals). In some circuits, the judicial council of the circuit have created a Bankruptcy Appellate Panel, in accordance with USC 158, which can hear appeals with the consent of the parties, though the parties may instead still choose to have their appeal heard by the district court. An appeal may also go directly to the circuit court of appeals in limited situations.

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Commented [H(41)]: 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?

Fiduciary duties are owed to the company and its shareholders. Specifically, the board owes duties of loyalty to the company's best interest and a duty of care in educated decision making (which requires them to make sure they have all key information and critically analyse that information before making a decision).

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

Even when directors make errors of judgment, there is protection available from this decision making under the business judgment rule (except for any gross negligence), whereby the board is presumed to have acted on good faith on the basis of reasonable information. This presumption can be rebutted by evidence.

Even in situations where the company is potentially or actually insolvent, the board does not owe specific duties to the creditors. However, creditors may bring derivative actions on behalf of an entity against the board when the entity is actually insolvent for a breach of their fiduciary duty. In the case of *Trenwick America Litig. Trust v. Ernst & Young, L.L.P.*, 906 A.2d 168 (Del. Ch. 2006), the Court made it clear that even when a company is insolvent, the board does not need to wind up operations and liquidate, they are still able to pursue in good faith strategies to maximise value.

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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.

Under the Bankruptcy Code a foreign proceeding is defined as 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 are subject to control or supervision by a foreign court, for the purpose of reorganization or liquidation" (Bankruptcy Code § 101(23)). Under this definition, an English scheme of arrangement is considered to be a foreign proceeding, unless it is manifestly contrary to US public policy.

Foreign main proceedings need to be commenced in the debtor's centre of main interests (COMI). A debtor's COMI is presumed to be its place of incorporation, though this is a rebuttable presumption. Gambling Corporation is incorporated in Greece, which means the COMI is presumed to be in Greece. Its principal place of business is also Greece, which also indicates the COMI is Greece.

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

In assessing whether the COMI is England vs Greece, the Court could also consider the location of management, headquarters, primary assets, majority of creditors and the jurisdiction whose law will apply to most disputes. However, based on the limited evidence above, it appears that the scheme of arrangement would not be a foreign main proceeding.

In order for the scheme of arrangement to qualify as a foreign non-main proceeding, Gambling Corporation would need an establishment (a place where it carried out non-transitory activity) in England. In this regard, Gambling Corporation's bonds are covered by English Law and it has operations in London. Accordingly, the scheme of arrangement could be granted recognition as a foreign non-main proceeding.

Commented [H(52)]: Correct, 1 mark, the London casino would be an establishment

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

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 filing of a chapter 11 petition creates an automatic worldwide stay to prevent interference with the estate of the debtor. Further analysis in respect of each situation is summarised below:

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Ship Co:

The stay would automatically apply to the litigation from ShipCo, so that it could not continue with the litigation relating to pre-petition claims.

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US Department of Justice:

The automatic stay does not extend to any criminal proceedings or regulatory investigations. Accordingly, the chapter 11 proceedings would not stop the US Department of Justice's investigations. It is also worth noting that any post-petition fines may be treated as administrative expenses and therefore given priority ("American Bankruptcy Institute" at <<https://www.abi.org/abi-journal/the-care-and-feeding-of-state-regulators-in-chapter-11-cases>>, accessed 27 February 2022).

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USA Bank:

The automatic stay has worldwide effect on the debtor's estate, so would cover the refinery in the Philippines. This would prevent USA Bank from foreclosing on the refinery.

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

Rent:

The stay would prevent the landlord from continuing with any recovery actions.

Commented [H(59)]: Correct, 1 mark, the landlord could not evict because the lease had not expired pre-bankruptcy

Question 4.3 [6 marks]

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

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

- (i) Assume and assign the trademark license?

While Oil Corp may be able to assume the license, Plastic Corp cannot be compelled to accept performance from the counter party under an assignment due to section 365(c) of the Bankruptcy Code. Therefore, the assignment can only be undertaken with Plastic Corp's consent.

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

- (ii) Reject the patent licenses?

Under Bankruptcy Code section 365(n), Plastic Corp can elect to retain its rights to continue to use Oil Corp's intellectual property, provided that it continues to comply with its obligations under the license. Therefore, Oil Corp cannot reject the patent license.

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Commented [H(64)]: Correct, 1 mark

- (iii) Sell the manufacturing facility clear of the USA Bank lien?

The manufacturing facility can be sold free of any creditors' interests, under a 363 sale. In order to qualify as a 363 sale, the debtor needs to prove that it is undertaking this transaction in its business judgment and that it is in the best interests of the estate. The sale itself needs to be sanctioned by the Court as well. However, any proceeds from the sale would be paid over to USA Bank under its lien.

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*** End of Assessment ***