



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 33.5/50

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

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Which of the following statements regarding executory contracts is **false**?

- (a) Executory contracts are clearly defined by the bankruptcy code.**
- (b) Chapter 11 debtors have greater flexibility than chapter 7 debtors on when they may assume, assign or reject an executory contract.
- (c) In the most common formulation, executory contracts are defined as those where both sides to a contract have material unperformed obligations.
- (d) A court will generally defer to a debtor's business judgment regarding whether to assume or reject an executory contract.
- (e) Under the hypothetical test, a debtor cannot assume an executory contract if the debtor could not also assign the contract.

Question 1.3

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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

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.

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Question 1.5

Which of the following statements regarding cramdowns is **true**?

(a) If one insider creditor approves of the plan of reorganization, all other impaired classes may be crammed down.

(b) Because cramdowns do not require the consent of all classes, the plan of reorganization may not be fair and equitable to all impaired classes.

(c) Differential treatment of different classes is permitted if there is a reasonable, good faith basis for doing so and such treatment is required for the plan of reorganization to be successful.

(d) Class definition is rarely a battleground when a debtor tries to cramdown classes.

(e) Dissenting creditors are not permitted to challenge the classification of a creditor supporting the cramdown.

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Question 1.6

Which of the following statements about the plan exclusivity period is **true**?

(a) The exclusivity period is 1 year.

(b) The exclusivity period cannot be extended.

(c) The exclusivity period cannot be shortened.

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(d) During the exclusivity period, only a creditor may propose a plan of reorganization.

(e) During the exclusivity period, only the debtor may propose a plan of reorganization.

Question 1.7

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Which of the following statements about chapter 15 is **false**?

(a) The automatic stay applies upon the filing of a petition for recognition.

(b) A debtor cannot be subject to an involuntary chapter 15 proceeding.

(c) A chapter 15 petition must be filed by a foreign representative.

(d) The automatic stay applies only to property within the territorial jurisdiction of the United States.

(e) Recognition may be granted to a foreign proceeding as either foreign main or foreign non-main.

Question 1.8

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

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

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

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

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

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

Question 1.9

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If a debtor rejects an executory trademark license agreement under which it licenses a trademark to its counterparty, which of the following is **true**?

(a) The counterparty has a claim for damages for breach of contract.

(b) The counterparty must immediately stop using the trademark.

(c) The counterparty can continue using the trademark for the remaining period of the license.

(d) Both (a) and (b).

(e) Both (a) and (c).

Question 1.10

Who may serve as a foreign representative to seek recognition of a foreign proceeding under chapter 15?

- (a) The board of directors of the debtor if it is a debtor-in-possession in the foreign proceeding.
- (b) An insolvency professional appointed by a creditor where the foreign proceeding is an involuntary receivership.
- (c) An officer of the debtor if it is a debtor-in-possession in the foreign proceeding.
- (d) An insolvency professional appointed by the court overseeing the foreign proceeding.
- (e) All of the above.

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QUESTION 2 (direct questions) [10 marks]

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Question 2.1 (2 marks)

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

Answer

A voluntary petition for bankruptcy is commenced by a debtor. The debtor is asked to file schedules or forms to disclose the lists of assets and creditors, but it needs not be or claim to be insolvent.

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An involuntary petition for bankruptcy is commenced by qualified creditors against an eligible debtor under either chapter 7 or 11. It cannot be commenced under the other chapters or against a farmer or not-for-profit corporation. There is a requirement to the number of petitioning creditors.

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The involuntary petition requires the petitioning creditors to allege either that the debtor is generally not paying its debts as they become due, unless they are the subject of a bona fide dispute as to liability.

Question 2.2 (2 marks)

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

Answer

Violation of the automatic stay constitutes a contempt of court and the act is void or voidable depending on the circuit in which the bankruptcy is pending. Sanctions against the violator include payment of the debtors' attorneys' fees and requiring the violator to take affirmative acts to undo the effect of its violation. A coercive contempt sanctions may be imposed until the violation has been rectified if the violator not act promptly.

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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?

Answer

A class of claims is impaired under a plan unless, as to every claim or interest in the class, the plan:

1. leaves unaltered the legal, equitable, and contractual rights to which such claim or interest entitles the holder of such claim or interest,
2. except that a class may be deemed unimpaired where the plan reverses contractual acceleration by curing any monetary default and compensating the holder for any damages.

A proposed plan of reorganization may be confirmed by cramming down dissenting impaired classes. When using cramdown, the impaired claim of an insider is not entitled to vote. Given that at least one impaired class voted to accept the plan, and the plan followed the other requirements as well as be fair and equitable to the non-consenting impaired classes, cramdown can be used to mitigate the holdout problem and approve a 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?

Answer

Preferences is a transfer of the debtor’s property made in a suspect period (90 days for third parties and 1 year for insiders) before the petition date that must be returned to the estate if it exceeds the amount the recipient would have been received in a chapter 7 liquidation had the transfer not been made. Preferences only arise where the debtor is paying a creditor for a pre-existing debt.

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

Answer

Constructive fraudulent conveyances are proven by showing that the debtor received less than reasonably equivalent value in exchange for a transfer or incurrence of obligation and either one additional factors were present, one of which is the debtor was insolvent at the time of or became insolvent as a result of the transaction.

For a preference claim, the debtor is presumed to have been insolvent on and during the 90 days prior to the petition date for the purposes of determining preference claims.

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

Commented [H(22)]: Incorrect, the creditor may vote but it cannot be the deciding vote for a cramdown. An impaired creditor who will receive nothing under the plan cannot vote and is deemed to reject the plan.

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Commented [H(24)]: Correct, 1 mark

Commented [H(25)]: This is an option but not a required element, The correct response is preferences

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

Answer

An **actual fraudulent conveyance** is proven by showing that the debtor made a transfer or incurred an obligation with actual intent to hinder, delay or defraud the creditors. The intent may be proven circumstantially by reference to badges of fraud developed in state fraudulent transfer law.

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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?

Answer

In *Stern v Marshall*, the US Supreme Court ruled that, even in core proceedings, a bankruptcy court cannot issue final orders that invade Article III jurisdiction. Although 28 USC §157 provides that a counterclaim is a core proceeding as to which a bankruptcy court can issue a final order, bankruptcy courts are not Article III courts and are not adjuncts to Article III courts, they cannot hear claims that must be adjudicated by Article III courts. The US Supreme Court therefore held that the bankruptcy court's issuance of a final order over a state law claim was unconstitutional under Article III

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After the rulings in *Stern v Marshall*, bankruptcy judges may determine a core proceeding over which they lack constitutional authority by issuing a report and recommendation for review by the district court, or may issue final orders with the consent of the parties. The litigants are required to state in their pleadings whether they consent to the entry of final orders or judgment by the bankruptcy court, and by permitting a district court that determines that a bankruptcy court did not have jurisdiction to enter a final order to treat that its order as proposed findings of fact and conclusions of law.

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

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?

Answer

Automatic stay of creditor's action does not be invoked by filing of the petition under chapter 15. The stay arises only upon the petition of recognition of a foreign main proceeding being granted and is limited to the property of the debtor within the territorial jurisdiction of the United States.

Commented [H(33)]: Incorrect, the foreign representative cannot invoke the avoidance powers unless it files a plenary proceeding or invokes analogous claims under US or foreign law

The Bankruptcy Court may grant a stay or other assistance on an interim basis pending recognition or following recognition of a non-main proceeding.

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 test applicable for determining whether interim relief is warranted depends on the likelihood of success on the merits, risk of irreparable harm, balancing of the equities, and the public interest.

Upon the recognition of a foreign main proceeding, automatic stay is automatically applied to the debtor's property within the territorial jurisdiction of the United States.

If it is a foreign non-main proceeding, automatic stay may still be granted on a discretionary basis. To give such a discretion, the bankruptcy court must be satisfied that it is appropriate under US law for the assets concerned to be administered in the foreign non-main proceeding. The ability of the bankruptcy court to condition relief on sufficient protection of interest parties and to discontinue discretionarily granted relief on the application of an interested party makes recognition as a foreign non-main less protective than recognition as a foreign main proceeding.

Question 3.3 (4 marks)

Describe the differences between interlocutory and final orders and how an appeal may be taken from each. Which courts hear direct appeals from bankruptcy court orders?

Answer

Interlocutory order resolves only some issues or claims and may be appealed only with leave of the appellate court. While final order dispose of all issue, leaving nothing further to be decided. Final order may be appealed as of right.

Appeals from bankruptcy court are generally heard by the district court for the district the bankruptcy court sit. In the First, Sixth, Eighth, Ninth and Tenth Circuits, bankruptcy appeals are heard by a Bankruptcy Appellate Panel, convened from the judges of the bankruptcy courts within the circuit. The appellant has the option to request the appeal be heard by the district court instead. Further appeal of right to the circuit court o appeals is available.

Question 3.4 (5 marks)

What fiduciary duties do directors of Delaware corporations owe and to whom are the duties owed in the ordinary course of business? To whom are duties owed when the corporation is potentially or actually insolvent?

Answer

Under to the law of Delaware, directors owe a fiduciary duty of loyalty to the corporation's best interest and a duty of care in educated decision-making, but are protected from liability for errors of judgment by the business judgment rule. Under the business judgment rule, the board of directors, who owes the duties in the ordinary court of business, is presumed to have acted in good faith on the basis of reasonable information. This presumption can be rebutted only by showing that a majority of the board in fact were not reasonably informed, did not honestly believe that their decision was in the corporation's best interest, or were not acting in good faith. Unless this presumption is rebutted, the directors will not be liable in the absence of a showing of gross negligence.

Directors' duties are owed to the corporation and its shareholders, but not to creditors, even when the corporation is potentially insolvent. The Delaware Supreme Court has put to rest the suggestion that directors owe duties to creditors when a corporation is operating when it

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is potentially or actually insolvent. It is the creditors' duty to protect their interest by bringing derivative claim on behalf of the insolvent corporation.

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

Question 4.1 [4 marks]

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.

Answer

Under chapter 15, the requirements of recognition are minimal. 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. A foreign proceeding is defined by the US Bankruptcy Code 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 of the debtor are subject to control or supervision by a foreign court, for the purpose of reorganisation or liquidation. Under this definition, English scheme of arrangement could be granted recognition under US chapter 15 unless it is manifestly contrary to US public policy, but this is not the case here.

As to whether it is a foreign main or foreign non-main proceeding, it has to consider the centre of main interest of the Gambling Corporation, including the location of headquarters, management, primary assets, majority of creditors that will be affected by the relief requested by the foreign representative and the jurisdiction whose law will apply to most dispute. Typically, to the US law, it is presumed that the principal place of business and location of assets to determine jurisdiction and venue, but it is rebuttable.

In this case, it is likely that it is a foreign non-main proceeding as centre of main interest of the Gambling Corporation is not in the US. Because 1. the place of incorporation and principal place of business of the Gambling Corporation is in Greece; 2. It has assets in many international cities but not primary in the US; 3. the bonds are governed by English law, it is likely that the centre of main interest would be located in Greece or the UK.

Question 4.2 [5 marks]

Oil Corporation is incorporated in Delaware and has its principal place of business in Texas. Oil Corp is facing a number of challenges to its business. First, ShipCo, one of its key customers, has filed a breach of contract lawsuit in Texas state court alleging that Oil Corp sold it contaminated oil that caused USD 1 billion in damage to ShipCo's container ships. Second, the US Department of Justice is investigating whether Oil Corp illegally purchased oil from countries subject to US sanctions. Third, Oil Corp. has missed a payment on its secured loan from USA Bank, and USA Bank is threatening to foreclose on an Oil Corp refinery located in the Philippines. Fourth, because of all these distractions, Oil Corp has forgotten to pay rent on its Houston, Texas office space and its landlord is threatening to evict it. What would be the effect of Oil Corp filing a chapter 11 petition on each of these four situations?

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Commented [H(48)]: Total marks 0/4

Commented [H(49)]: Incorrect, the analysis is whether the COMI is in the same place as the foreign proceeding (ie the UK)

Commented [H(50)]: For this reason, COMI is likely to be in Greece, not English, so it cannot be a foreign main proceeding; it can be foreign non-main because there is a casino in London that is the establishment in the jurisdiction of the foreign proceeding

Commented [H(51)]: Total marks 5/5

Answer

1. ShipCo's proceeding in Texas to claim damages in breach of contract by Oil Corp

By filing a chapter 11 petition, Oil Corp is granted worldwide automatic stay. The automatic stay will prohibit litigation on pre-petition claims. ShipCo's proceeding is therefore be stayed.

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

2. US Department of Justice's investigation of illegal act by Oil Corp

Although the automatic stay is an injunction against creditor, it is subject to certain statutory exceptions, which include criminal proceedings and regulatory investigations. Therefore, by filing a chapter 11 petition, Oil Corp will not be able to evade from the investigation of US Department of Justice.

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3. Threat from USA Bank to foreclose refinery of Oil Corp located in the Philippines

By filing a chapter 11 petition, an act to obtain possession or control of the property of the debtor and perfection or enforcement of a lien against the property of the debtor is prohibited. USA Bank therefore is not allowed to foreclose the refinery of Oil Corp located in the Philippines since the US automatic stay is with a worldwide effect. Unless the Court considers that Oil Corp is attempting to delay, hinder or defraud creditors by transferring the properties without the consent of USA Bank or Court's approval, the automatic stay will not be lifted.

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

4. Threat from landlord to evict Oil Corp from Houston and Texas office

By filing a chapter 11 petition, the landlord cannot initiate a proceeding or take enforcement to evict Oil Corp from Houston and Texas office. However, there is an exception to allow eviction of a debtor-tenant from non-residential property where the lease has expired. If the lease of Houston and Texas office has expired, the landlord is able to evict Oil Corp accordingly.

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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?

Answer

1. Assume and assign the trademark license

The Oil Corp can assume and assign the trademark to a transferee. The transferee must give adequate assurance of future performance. Consent of Plastic Corp is only required when the contract is one to make a loan or other financial accommodation, or where substantive non-bankruptcy law provides that Plastic Corp cannot be compelled to accept performance from the transferee.

Commented [H(58)]: Here, trademark law provides that a licensor can refuse to accept performance from an assignee, so the license cannot be assigned without consent

2. Reject the patent licenses so the purchaser has the exclusive right to use the patents
Under §365(n), licensees of the patents owned by the debtor are protected such that their licenses may not be terminated in connection with the sale of the patent without their consent. Therefore, Oil Corp is unable to reject the patent licenses to Plastic Corp to make an exclusive right to use the patents by the new purchaser without the consent of Plastic Corp.

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Commented [H(60)]: Correct, 1 mark

3. Sell the manufacturing facility free and clear of the USA Bank lien
Selling the main manufacturing facility in Dallas is a non-ordinary course transaction. Oil Corp can sell its property free and clear of creditor interests with court approval in a 363 sale. However, as that facility was granted a lien to USA Bank, the Oil Corp cannot sell the secured facility without USA Bank consent pursuant to §363(f).

Commented [H(61)]: Incorrect, the sale can be free and clear of the lien with the lien attaching to the proceeds

*** End of Assessment ***