



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)]: Incorrect, the correct response is (a)

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

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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

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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?

The primary difference is that a voluntary petition is made by the debtor themselves of their own accord, whereas an involuntary petition is in respect of proceedings commenced against an eligible debtor under chapter 7 or chapter 11 by a creditor. These are the only chapters under which involuntary proceedings can be commenced and if there are 12 or more creditors then at least 3 must join the petition.

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

A voluntary petition also does not require an allegation of insolvency (as it is voluntary), whereas the petitioning creditor(s) of an involuntary petition must allege insolvency of some description.

Question 2.2 (2 marks)

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

Violation of the automatic stay is considered contempt of court. The party violating the stay may be subjected to settlement of the debtors' attorneys' fees and may have to act in such a manner to undo the violation. In addition, if the court does not consider that the party in violation is not taking corrective action promptly enough then other such consequences such as daily fines can be imposed.

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Question 2.3 (3 marks)

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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 plan of reorganisation requires for the designation of classes of claims held by creditors. Following that, the plan of reorganisation must specify which classes are unimpaired and which are impaired. As stated in the Foundation Certificate: Module 3A Guidance Text, "a

class is impaired unless, as to every claim or interest in the class, the plan leaves the holder's "legal equitable and contractual rights unaltered"...". Importantly, any delay to settlement of the debt due in full is considered an impairment and only impaired classes have the right to vote.

Commented [H(20): Correct, 1 mark, an impaired claim that will receive nothing under the plan cannot vote and is deemed to reject the plan

In instances where, for example, the plan allows for the compensation of damages, the designation of class would be unimpaired.

Further, a plan of reorganisation can be confirmed via the "cramdown" method, which would solve the issue of an impaired claim not entitled to vote. To "cramdown", the plan must be fair and equitable and all other requirements of the confirmation of the plan of reorganisation must be met. At least one impaired class must have voted to accept 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?

An antecedent debt, otherwise known as a pre-existing debt, must be applicable for a preference to arise i.e. the debtor must be making payment against a pre-existing debt. The debt is not incurred until the good/service is received, therefore, pre-payment for goods and services that remain undelivered is not considered preferential. It must be determined when the debt was incurred and when the transfer of interest in the debtor's property occurred.

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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?

For the purpose of determining a preference, the debtor is presumed to be insolvent during the 90 days prior to the date of the petition. This time period may be disputed by a creditor with evidence and the onus of proving insolvency at the time of the transfer on a balance sheet basis is on the debtor or the trustee.

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

There is no requirement to show fault of the debtor in connection with the payment having been made.

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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 generally governed by the 1978 Bankruptcy Code, rather than Article III of the US Constitution and as a result, the US Supreme Court have historically been known to take the view that appointments have not been made pursuant to Article III and therefore

the subsequent provisions and protections of Article III do not apply and a Trustee cannot exercise jurisdiction over matters subject to Article III. The referral statute sought to create a distinction between core and non-core matters, in order to provide clarity on ensuring only core proceedings were heard in the bankruptcy court (and non-core only if they are sufficiently and adequately connected to the bankruptcy proceedings). By the time the Bankruptcy Code was amended in 1984, core proceedings were well established.

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Stern vs Marshall was a matter that was heard in 2011 under which the US Supreme Court ruled that a bankruptcy court cannot issue final orders that enter the jurisdiction of Article III, since in this case there were separate state court proceedings and parallel proceedings in the federal courts. Though the bankruptcy court issued its judgment first, the state court case continued and the bankruptcy judgment was appealed. Despite the provisions allowing the bankruptcy court to issue a final order, the US Supreme Court held that it was unconstitutional under Article III.

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The key movement brought about by this case was that a decision (and award) that was granted in the district court was subsequently declared void by the ruling of the Supreme Court on the basis of it being non-core cause of action.

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 case under chapter 15 may only be commenced by the foreign representative of a debtor; it cannot occur on an involuntary basis by the foreign representative of the creditor.

Article 23 of the Model Law provides for the powers of a foreign representative upon recognition of a foreign proceeding with avoidance actions. The avoidance powers of the Bankruptcy Code may not be invoked in the absence of chapter 7 or 11 proceedings.

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The foreign representative may commence plenary proceedings to obtain access to the avoidance powers of the Bankruptcy Code.

Commented [H(31)]: Correct, 1 mark, also the foreign representative may bring analogous claims under US and foreign 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?

Interlocutory orders only resolve certain issues or claims and are usually issued at some stage between the commencement and conclusion of a cause of action, whereas, final orders resolve all issues leaving no outstanding matters to be resolved.

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Commented [H(34)]: Correct, 1/2 mark

For final orders, there is a right of appeal whereas interlocutory orders may only be appealed with the leave of the appellate court. The decision to pursue either an appeal as of right or an interlocutory appeal divests in the bankruptcy court of jurisdiction to alter its decision, but does not stay its effect.

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Commented [H(36)]: Correct, 1/2 mark

Generally speaking, bankruptcy court appeals are heard by the district court, however, it has been known for the appeal to go directly to the court of appeal or heard by the Bankruptcy Appellate Panel. It can often be subject to debate as to whether there is a clear distinction between an interlocutory order and a final order. An order that is final because of the

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

bankruptcy court's authority to enter it, is not considered final for the purposes of appeal if it does not resolve the entire disputed issue.

The level of review and consideration given to an appeal would depend on whether the proceeding is a core proceeding over which the bankruptcy court had authority to enter a final order, or whether it was a non-core proceeding over which the authority to enter a final order was absent.

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?

Delaware is a distinguished, preeminent US jurisdiction in respect of corporate law and director liability is more limited than elsewhere in the US. A director of a Delaware corporation has a fiduciary duty of **loyalty** to that corporation and must act in the best interests of the corporation. They also have a duty of **care** in respect of decisions that are made, however, thanks to the 'business judgement rule', are generally protected from any liability that may occur as a result of an error in judgment.

Under the 'business judgment rule', the assumption is there that the director has acted in good faith and in the best interests of the corporation, based on the information available. This can only be revoked if it is properly shown that reasonable information was not available or that it can be evidenced that the decision was not in good faith. Unless this evidence is provided, the directors will not be liable unless gross negligence can be shown.

In cases where a transaction approved by a board is not independent or where the controlling shareholder is party to both sides of the transaction then the business judgment rule does not apply unless the entire fairness standard is satisfied.

Regardless of whether or not the company is insolvent, the directors' duties are owed to the **corporation and its shareholders, not to the creditors**. Even when carrying on the normal course of business during the period prior to insolvency, within the 'zone of insolvency' (or when indeed, insolvent), the directors do not owe their duties to the creditors. Therefore, wrongful trading does not exist under Delaware law.

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.

In the US, there are minimal requirements for recognition. 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". Further,

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there does not necessarily need to be similarities to a US bankruptcy case in order to be recognised. English Schemes of Arrangement have been granted recognition in the US under the wide definition of a foreign proceeding as provided for in the Bankruptcy Code.

Considering the circumstances of this matter, I would conclude that this would be a foreign non-main proceeding. Greece would be the jurisdiction of foreign main proceeding as this is Gambling Corporation's Centre of Main Interests. Whether or not the proceedings are foreign main or foreign non-main determines the relief that would be available, following recognition.

Gambling Corporation can still be granted recognition under Chapter 15 as the debtor company has an establishment in the USA, being a place where it carries out non-transitory economic activity, prior to the commencement of the Chapter 15 proceedings.

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?

In chapter 11 proceedings, the debtor remains in possession and may operate in the ordinary course of business and reorganise or liquidate. Because of this, Chapter 11 is described as a "debtor-friendly rehabilitation regime". It features an automatic stay effective upon filing the petition which allows the debtor company to sell assets, avoid pre-petition transactions, reject any unprofitable contracts and adjust debts through a plan of reorganisation. To the extent there is lack of consent from the creditors, chapter 11 proceedings often need the involvement of the Court.

We will turn to each of the predicaments individually to determine the effect of Oil Corp filing a chapter 11 petition and the impact it would have on that situation:

1. ShipCo, a key customer, has filed a breach of contract lawsuit in Texas alleging that Oil Corp sold it contaminated oil that caused USD 1 billion in damage to ShipCo's container ships.

The action of ShipCo filing a lawsuit in a state court against Oil Corp is prohibited under the protection of the automatic stay brought about by the Chapter 11 petition. The automatic stay has a worldwide effect therefore any action to commence a lawsuit outside of the US is not allowed. Under the Chapter 11 proceedings, Oil Corp are entitled to pursue the steps required to reject burdensome contracts.

2. US Department of Justice investigating whether Oil Corp illegally purchased oil from countries subject to US Sanctions

Criminal proceedings and regulatory investigations are exempt from the automatic stay brought about the filing of a charter 11 petition, therefore, these investigations will still continue throughout the course of the reorganisation. It is likely that provisions for such will need to be made in the plan of reorganisation and Oil Corp

Commented [H(47): Greece is most likely to be the debtor's COMI, 1 mark

Commented [H(48): Incorrect, the relevant location of the establishment is the jurisdiction of the foreign proceedings, and the debtor has a casino in London, so would satisfy this requirement.

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Commented [H(50): Correct, 1 mark

Commented [H(51): Partially correct, 1/2 mark, the litigation has already been commenced in the facts, but the stay would prevent them from continuing

Commented [H(52): Correct, 1 mark

should cooperate with the US Department of Justice's requests for information.

3. Oil Corp 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

Once again, the automatic stay is worldwide and foreclosure on Oil Corp's non-US secured property is covered under the terms of the automatic stay that will be applicable upon filing the chapter 11 petition. Under the chapter 11 proceedings, the debtor in possession may deal with its property in the ordinary course of business without creditor interference and is free to sell its property with court approval in a 363 sale. The sale could be pursued via an auction with a 'stalking horse' bidder, where the property is marketed and interested parties are invited to conduct their due diligence, ultimately leading to negotiations with a single party. It is important to note that the secured creditor, USA Bank, may "credit bid" for the property, through which they offset a portion of the purchase price against the amount owing under the secured charge.

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4. Oil Corp has forgotten to pay rent on its Houston office space and the landlord is threatening eviction.

The scope of the automatic stay effective on filing the chapter 11 petition is broad and covers any act to obtain possession or control of property of the estate and Oil Corp are entitled to lease property for the ordinary course of business. Therefore, during this period of reorganisation, Oil Corp would be protected from eviction and the landlord would be invited to vote on the reorganisation plan as a creditor. However, it should be considered whether the property is essential for the ongoing trade of the business in line with the ordinary course of business; given the property is not owned by Oil Corp, it could be argued that the property is not necessary for reorganisation, therefore, the landlord could request that the stay be lifted in this regard.

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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?

A 363 sale allows the debtor in possession to sell its property free and clear of creditor interests with court approval. It is used as a vehicle to sell the debtor's assets to a strategic purchaser or successor corporate entity and the purchase price is likely to be higher as the business is continuing to operate.

Under a 363 sale, the trademark licenses can be assumed and assigned as a transfer of interest in key contracts therefore objective (i) is achievable under the 363 sale.

Commented [H(56)]: Incorrect, because trademark law permits a licensor to refuse to accept performance of a licensee, the contract cannot be assumed and assigned without consent

However, the licensees of patents may not be terminated in connection with the sale without consent, therefore this element of the sale cannot be achieved without the consent of Plastic Corp. To that end, one would think that a sale of this business and transfer of license would be in the interest of Plastic Corp to ensure they still have the benefit of the going concern business, therefore, you would expect that consent to be granted. Therefore, whilst (ii) is achievable under the 363 sale, Plastic Corp's consent is required.

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

The manufacturing facility is subject to a lien in favour of USA bank in respect of a USD 500 million loan. In the first instance, it would be in the interest of Oil Corp to invite USA Bank to submit a "credit bid" for the property, under which it can offset a portion of the purchase price against the amount of its claim secured by the property.

That being said, under chapter 11 the debtor in possession does have the ability to sell assets free and clear of liens. Pursuant to Section 363(f) of the Code, the secured creditor is required to consent to the sale so this cannot be done without consulting USA Bank. A lien holders interest can be extinguished under state law and in that case, the USA Bank would be paid in order of their priority from the proceeds of sale. The lien holder tends to have first priority interest and therefore is often quite heavily involved in the 363 process. Therefore (iii) is achievable but USA Bank's consent is required.

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*** End of Assessment ***