



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 6/10

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

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

Commented [H(7): Correct, 1 mark

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

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

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

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).

Commented [H(9)]: Incorrect, the correct response is (a)

Commented [H(10)]: Incorrect, the correct response is (c)

Commented [H(11)]: Correct, 1 mark

Question 1.10

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

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

Commented [H(12): Incorrect, the correct response is (e)

QUESTION 2 (direct questions) [10 marks]

Commented [H(13): Total marks 6.5/10

Question 2.1 (2 marks)

Commented [H(14): Total marks 2/2

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

A voluntary petition is filed by the debtor/debtor company independently and through their/its own volition. There need be no allegation of insolvency made by the debtor. It is sufficient to file even a "naked" petition, i.e. one that does not contain a full and complete list of assets and/or creditors.

Commented [H(15): Correct, 1 mark

The involuntary petition on the other hand, requires a specific allegation of insolvency to be made by creditors that the debtor is unable to pay his debts as they fall due, or that "within 120 days before the filing of the petition, that a custodian other than a trustee, receiver or an agent appointed or authorized to take charge of less than substantially all of the property of the debtor for the purpose of enforcing a lien against such property, was appointed or took possession."

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Question 2.2 (2 marks)

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

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

A violation of the automatic stay will result in the violating party being found in contempt of court and is void or voidable. The violating party can be asked to pay the debtor's attorney's fees, or to pay a daily fine in a situation where the court has ordered the violating act to be undone, until such order has been complied with.

Commented [H(18): Correct, 1 mark

Commented [H(19): Correct, 1 mark

Question 2.3 (3 marks)

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

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 if it the plan of reorganization alters the creditor's legal, equitable and contractual rights.

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

Where full payment is delayed after the effective date of the plan, this will be considered an impaired claim.

However, the exception is where the plan reverses contractual acceleration by settling any monetary default and compensating the holder for damages. In this case, the full compensation eliminates the ability of a class to vote against the plan

Commented [H(22)]: In that case, the claim would not be impaired. An impaired claim that will receive nothing under the plan cannot vote and is presumed to reject the plan

The holder would be constructively regarded as unimpaired and by implication, conclusively presumed to have accepted the plan.

Question 2.4 (3 marks)

Commented [H(23)]: Total marks 1.5/3

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.

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

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

A constructive conveyance.

Commented [H(25)]: Incorrect, the correct response is "preference"

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

An actual conveyance.

Commented [H(26)]: Partially correct, 1/2 mark, the correct term is "actual fraudulent conveyance"

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

Commented [H(27)]: Total marks 10/15

Question 3.1 (3 marks)

Commented [H(28)]: Total marks 2/3

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

Article III of the Constitution vests "[t]he judicial power of the United States in one Supreme Court, and in such inferior Courts as the Congress may from time to time ordain and establish," and provides that the judges of those constitutional courts "receive for their services a compensation that shall not be diminished" during their tenure."

Thus Article III carves out the system of life-tenured and salary-protected judges, who are nominated by the President and confirmed by the Senate.

The issue in *Stern v Marshall* was whether a bankruptcy court judge who did not enjoy such tenure and salary protections had the authority under 28 U. S. C. §157 and Article III to constitutionally enter a final judgment on a non-core tort counterclaim brought by Stern.

Prior to the decision in *Stern v Marshall*, a bankruptcy court, although created by the 1978 Bankruptcy Code could deal with core proceedings of bankruptcy.

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

In *Stern v Marshall* the Supreme Court held that the Federal Judicial Code which addressed the bankruptcy court's jurisdiction in core proceedings, was unconstitutional and a bankruptcy court was not entitled to issue final order that invaded the jurisdiction granted by Article III.

Commented [H(30)]: Correct, 1 mark, the bankruptcy court does have jurisdiction to enter a final order on a challenge to a petition or with the consent of the parties

Question 3.2 (3 marks)

Commented [H(31)]: Total marks 2/3

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?

The powers of avoiding fraudulent conveyances (section 548) and preferences (section 547) granted under the Bankruptcy Code are excluded from the powers granted to a foreign representative.¹

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

Avoidance powers may only be awarded to the foreign representative in Chapter 7 or 11 proceedings.

Commented [H(33)]: Correct, 1 mark, alternatively the foreign representative may bring analogous claims under US or foreign law

The foreign representative is also granted the power of selling assets outside the ordinary course, free and clear of lien as provided for in section 363 of the Bankruptcy Code.

Question 3.3 (4 marks)

Commented [H(34)]: Total marks 2/4

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

Final orders dispose of all issues leaving nothing more to be decided. A final order is therefore binding on the parties.

Commented [H(35)]: Correct, 1/2 mark

An interlocutory order resolves only some or part of the issues of or in the main proceeding.

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

Final orders may be appealed as of right, whereas interlocutory orders require the permission of the appellate court. In *Bullard v Blue Hills Bank*, the Court held that an order which resolves the discrete dispute is a final order for appeal purposes.

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

However, the distinction whether the order is an interlocutory or a final one can be a grey area in certain instances such as deciding the post-petition interest rate applicable to the debtor's obligations.

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

The distinction is made as between constitutional bankruptcy judgments handed down by the Bankruptcy Court, which are not final if it does not resolve the entire issues in dispute; and, on the other hand, an order that resolves the entire issues and would not be appealable in the constitutional sense if the parties consented to the jurisdiction of the bankruptcy court.

The Court of Appeals may hear direct appeals where the Bankruptcy Court or district court certifies that either:

Commented [H(39)]: Typically, an appeal is heard by the district court in the district where the bankruptcy court sits, or in certain circuits by a Bankruptcy Appellate Panel

¹ However, the 5th Circuit U.S. Court of Appeals in *In re Condor Ins. Ltd.*, 601 F.3d 319 (5th Cir. 2010) held that a foreign representative could pursue "avoidance" remedies using the avoidance laws of the foreign jurisdiction (in *Condor*, the laws of Nevis) – see "Chapter 15 and cross-border insolvency" available online at https://www.shumaker.com/Templates/media/files/pdf/news/publications/7newsletter-chapter-15-and-cross-border-insolvency_x.pdf. Accessed 4th July 2022.

1. The appeal raises a question of law for which no precedent or controlling decision exists from the circuit court or the Supreme Court of Appeal; or
2. Immediate appeal may further advance the progress of the case.

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?

What fiduciary duties do the Directors of Delaware corporations owe?

Directors of Delaware companies owe a fiduciary duty of **care and loyalty to serve the best interests of the company.**
Directors must act in good faith and in educated decision making.

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

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

The liability of directors is protected by the business Judgment rule. Directors are presumed to have acted in good faith and/or made decisions based on reasonable information. The presumption is however rebuttable and can only be overcome by showing that the majority of the board were not reasonably informed, or acted in good faith, or did not honestly believe that the decision they made was in the company's best interests. Where the presumption is not rebutted, directors will not be held liable. The business judgment rule does not apply where the directors took decisions on the approval of transactions by a board majority that was not disinterested and independent, or where a controlling shareholder was on both sides of the transaction. In such a case, the transaction will be void unless the fairness standard is satisfied.

The exclusion from liability for breach of duty of care can be embedded in the company's Certificate of Incorporation, thus the directors are exempt from liability. However, breach of duty of loyalty to the company will never be incorporated into the company's Certificate of Incorporation.

To whom are these duties owed and when?

- (a) During the solvency of a company, directors owe a duty of care and loyalty to the **company**, and by implication, its **shareholders**.
- (b) When the company is teetering on insolvency (potentially insolvent), the fiduciary duties of the directors remain the same as found in the case of *In the matter of North American Catholic Educational Programming v. Gheewalla* (Del. Supr. 2007) where the Court held:

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

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

"[D]irectors owe their fiduciary obligations to the corporation and its shareholders.... When a solvent corporation is navigating in the zone of insolvency, the focus for Delaware directors does not change: directors must continue to discharge their fiduciary duties to the corporation and its shareholders by exercising their business judgment in the best interests of the corporation for the benefit of its shareholder owners."²

The Court went further to hold that the fiduciary duties of directors in a situation where the company operates in the zone of insolvency does not extend to creditors, as it would "create a conflict between those directors' duty to maximize the value of the insolvent corporation for

² B E Scheler *et al.* "Director Fiduciary Duty in Insolvency." Available online at <https://corpgov.law.harvard.edu/2020/04/15/director-fiduciary-duty-in-insolvency/>. Accessed: 4th July 2022.

the benefit of all those having an interest in it, and the newly recognized direct fiduciary duty to individual creditors.”³

- (c) Where the company is actually insolvent, the directors owe a fiduciary duty of good faith to both the shareholders and the creditors. However, creditors may not bring direct claims against directors for breach of fiduciary duties, but can assert derivative claims on behalf of the insolvent company. *Ghewalla* finds that creditors have rights of recourse through contract and statutory laws and therefore there is no need to extend the ambit for creditor-action on a breach of a fiduciary duty on this aspect.

Commented [H(45): Incorrect, the creditors are not directly owed any duty

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

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Question 4.1 [4 marks]

Commented [H(47): Total marks 1/4

Gambling Corporation is incorporated and has a principal place of business in Greece and it operates casinos and betting parlors in many international cities, including Athens, Las Vegas, London and Macau. Gambling Corp’s bonds (governed by English law) are due to mature in one (1) year, but it is unable to repay or refinance them. Gambling Corp is considering using an English scheme of arrangement to restructure the bonds.

Discuss whether the English scheme of arrangement could be granted recognition under US chapter 15 as a foreign main or foreign non-main proceeding.

INTRODUCTION:

Chapter 15 of the US Bankruptcy Code (“Code”) applies in cases where assistance is sought in the US by a foreign court or a foreign representative in connection with a foreign proceeding.

It is predicated upon Article 4 of the UNCITRAL Model Law with virtually no amendments. Consequently, section 1 of the Model Law can be found embedded into section 1501 of the Code.

In Chapter 15 proceedings, key principles such as the facilitation of cooperation, an increase in legal certainty, the fair and efficient administration of cross-border insolvencies, protection and maximization of the debtor’s assets and facilitating the rescue of troubled businesses underscore the purpose of recognition.

ISSUE:

The issue herein is whether the English Scheme of Arrangement could be granted recognition, and if so, whether it would be recognized as a foreign main, or foreign non-main proceeding in the USA?

The first issue is essentially a procedural one, and the second, substantive.

³ *ibid.*

LAW:

Preliminaries – Procedural Aspects

Recognition of a foreign proceeding commences by the filing of a petition by the foreign representative under section 1504 read with section 1515 of the Code.

The petition will only be recognized if filed by a debtor. Where a foreign representative acts on behalf of a creditor, such filing is impermissible.

In order to obtain recognition in the USA, the foreign representative must satisfy the threshold requirements. These are:

1. A foreign court is dealing with a pending proceeding or administrative procedure; and
2. The foreign representative is authorized to act in that proceeding.

The foreign proceeding itself need not be a carbon copy of the US version of Bankruptcy proceedings. At a minimum standard, the judgment must relate to a collective judicial proceeding or administrative procedure against the debtor under general bankruptcy laws such as insolvency or the adjustment of a debt and it must emanate from a court under which the assets and affairs of the subject to the control of the foreign court.

Substantive Law

Under section 1502(4) of the Code, a “foreign main proceeding” means one “pending in the country where the debtor has the center of its main interests” or “COMI.”

Although COMI is not defined by the Code, COMI may be understood as a single geographical *locus* in which the centre of the main interests of a company is the directional factor in deciding jurisdiction.⁴

To anchor jurisdiction to a main proceeding, the Model Law defines COMI as the place of the proceeding which is “expected to have principal responsibility for managing the insolvency of the debtor regardless of the number of States in which the debtor has assets and creditors, subject to appropriate coordination procedures to accommodate local needs.”⁵

The Code provides that in establishing a debtor company’s COMI, absent evidence to the contrary, the debtor’s registered office is presumed to be its COMI.⁶ Thus, a rebuttable presumption exists wherein a debtor’s COMI is presumed to be its place of incorporation.

Section 541 of the Code states that filing a bankruptcy petition brings into existence an estate made up of all property, “*wherever located.*”

Therefore a petition may be filed by “*a person that resides or has a domicile, a place of business, or property in the United States.*”⁷

Property has been interpreted to include a bank account in the country.⁸

⁴ I Mevorach, “The ‘Home Country’ of a Multinational Enterprise Group Facing Insolvency” in *The International and Comparative Law Quarterly* Apr. 2008, Vol. 57, No. 2 pp. 427-448 available online at <https://www.jstor.org/stable/2048821>. Accessed 14th October 2021.

⁵ UNCITRAL Model Law on Cross-Border Insolvency with Guide to Enactment and Interpretation.

⁶ Section 1516(c) of the Code.

⁷ O Couwenberg and SJ Lubben, “Corporate bankruptcy tourists” *The Business Lawyer* (2015) Vol. 70, No. 3 pp. 719-75. Available online at <https://www.jstor.org/stable/10.2307/26417514>. Accessed 11th November 2021. (“Couwenburg”).

⁸ *Ibid.* The 2014 bankruptcy filing of a Company in Chile, which used its 7 bank accounts it had in the New York to successfully open a bankruptcy proceeding in the US is a case in point.

It is precisely the wording of section 541 that has set the cat amongst the pigeons when deciding whether to recognize a proceeding as a foreign main, or non-main proceeding. Courts have over time, determined COMI along factual and objective lines⁹ and this has led to the employment of two distinct but overlapping tests:

1. The “nerve-center”¹⁰ or principal place of business test; and
2. The objective factors test.

The nerve-center test was applied in *In re Tri-Continental Exchange Ltd*¹¹ wherein the court found that the registered office of a debtor is evidence that is probative of its COMI. Thus the Court held that the COMI of certain debtor insurance companies was St. Vincent and the Grenadines; it therefore granted recognition of the case as a foreign main proceeding under Chapter 15.

In *In re SPhinx, Ltd*¹² the court refined and evaluated COMI by asking where a third party, assessing certain objective factors, would perceive the corporate debtor to conduct the bulk of its business operations.

The Court concluded that while the presumption of the debtor’s COMI is its place of registration or incorporation, various factors could nevertheless rebut it, including:

1. Where the debtor’s headquarters are located,
2. Where its management rests,
3. Where its primary assets may be located,
4. Where the majority of creditors can be found, either those of the debtor, or those affected,
5. The law of the most applicable jurisdiction; and
6. The perception of third parties.

The following cases demonstrate a gradual refinement of the application of the “objective-factors” test:

In *In re British American Insurance Co., Ltd*¹³ the Court found that although the debtor was incorporated in the Bahamas, its headquarters were located in Trinidad. This was where the debtor’s subsidiary conducted its financial, administrative, actuarial, legal, policy, administration, and claims processing, as well as the day-to-day affairs of the company.

The Court further found that its assets were located in its Eastern Caribbean branches, while its creditors were located outside of the Bahamas.

Lastly, the Court considered the objective perception of its creditors and found they were unlikely to perceive that the debtor’s operational hub was in the Bahamas given that its business was not conducted there. The Court therefore held that the Bahamas were not its COMI and did not fall within the meaning of “foreign main proceeding.”

In *In re Millenium Global Emerging Credit Master Fund Limited*¹⁴ despite an absence of management, investors, creditors, or property in Bermuda, the Court nevertheless concluded that the debtor’s COMI was in Bermuda.

This was because in the first place, two of the debtors’ three directors were located in Bermuda and these directors had the right to replace all of the debtors’ other agents, and to determine

⁹ *Morning Mist Holdings Ltd v Krys (In re: Fairfield Sentry Ltd)*. (“Morning Mist”).

¹⁰ B Rochelle, “Cross-Border Insolvency in the U.S. and U.K.” (2017) *The International Lawyer* Vol. 50, No. 2 pp. 391-400 at 395.

¹¹ *In re Tri-Continental Exchange Ltd.*, 349 B.R. 627, 635 (Bankr. E.D. Cal. 2006).

¹² *In re SPhinx, Ltd.*, 351 B.R. 103, 117-18, 351 B.R. 103, 56 (S.D.N.Y. 2006).

¹³ *In re British American Insurance Co. Ltd.*, 425 B.R. 884, 909, 52 Bankr. Ct. Dec. 286 (S.D. Fla. 2010).

¹⁴ *In re Millennium Global Emerging Credit Master Fund Limited*, 458 B.R. 63, 77 (S.D.N.Y. 2011).

whether to place the funds into an insolvency proceeding. Also, the funds' bank, their custodian, and auditors also resided there.

In *Morning Mist Holdings Ltd. v. Krys, (In re Fairfield Sentry Ltd.)*¹⁵ the Court recognized the proceedings in the British Virgin Islands as a Main proceeding as the debtors' base of operations—its COMI—was the British Virgin Islands rather than the US. Reaching this conclusion, the court found that the debtors had effectively quit operating in New York more than eighteen months before filing the recognition petition in the U.S., and seven months before commencing the foreign insolvency proceedings. Moreover, after ceasing operations, the debtors made most of their administrative decisions from the British Virgin Islands.

In the *Bear Sterns High-Grade Structured Credit Strategies Master Fund, Ltd* case, the US Bankruptcy Court rejected an application for the commencement of a foreign main proceeding finding that the Cayman Islands could not be the COMI for the Cayman-Islands hedge fund due to its licensing which made it exempt from operations in the Cayman Islands. This, although its registered office was located in the Cayman Islands. The company had neither employees nor managers in the Cayman Islands. Both its investment manager and administrator were based in the US, along with its books and records, and all of the company's liquid assets. For all these reasons the Cayman liquidation could not be recognized as a foreign main proceeding.

Following the *Bear Sterns* decision, US Courts lean in favour of assessing COMI as at the date of the petition filed, and not the commencement of foreign proceedings.

APPLICATION OF THE LAW TO THE FACTS:

Gambling Corporation is incorporated and has its principal place of business in Greece. Applying *Tri-Continental Exchange Limited*, it may be inferred absent evidence to the contrary that this is where its headquarters are and its management rests. If so, Gambling Corporation satisfies the presumption that the company's COMI is Greece and the place at which the main proceeding should be opened.

The fact of an operation in Las Vegas leads to the reasonable inference that there is property within the jurisdiction of the USA that would found an application for recognition of a foreign proceeding.

But Gambling Corporation's primary assets are English bonds which are in need of post-commencement finance.

These facts would be attractive to a debtor who desires to found jurisdiction for the recognition of a *main* proceeding where the law may be most suited to it.

However, applying the *Bear Sterns* decision on the point of primary assets alone could also mean that the Courts of the US would recognize England as the jurisdiction of the main proceeding.

In view of the above, the answer as to whether the US Courts should recognize the English Scheme of Arrangement as a Main proceeding will depend on the law which is most suited to its application. Practically, the English Scheme of Arrangement may be a convenient *locus* for the disposal of the bankruptcy for all parties concerned.

Question 4.2 [5 marks]

¹⁵ Morning Mist note 9 above.

Commented [H(48): Correct, 1 mark

Commented [H(49): Incorrect, because England is not the COMI, the proceedings cannot be recognized as foreign main proceedings, but because there is an establishment (a casino) in England, recognition as a foreign non-main proceeding is appropriate.

Commented [H(50): Total marks 3.5/5

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

ISSUE

The issue herein involves an analysis of the effect of filing a Chapter 11 petition in the case of (a) a breach of contract; (b) an illegal transaction; (c) a foreclosure; and (d) an eviction.

LAW:

Introduction

The filing of a chapter 11 petition by a debtor commences the reorganization of a company and triggers a number of consequences. **The primary consequence of a chapter 11 proceeding is to effect a worldwide automatic stay or moratorium on creditor action.**

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In terms of the stay under the Code, litigation and enforcement are prohibited, as are any attempts to collect on pre-petition claims. Set-off is prohibited. Any act to obtain possession or control over property, or the creation, perfection or enforcement of a lien is prohibited.

Other consequences include the avoidance of preferences or fraudulent transfers and the ability of the debtor to reject burdensome contracts, sell assets free and clear of any lien, and pursue claims for recovery. Acts taken in violation of the stay amount to contempt of court and are void or voidable.

No trustee is appointed in a chapter 11 proceeding, but a debtor-in-possession exercises these powers.

Executory Contracts

In addition to the automatic stay, the filing of Chapter 11 proceedings outstanding obligations as between the debtor and counterparty, known as executory contracts must be resolved.

Executory contracts are not defined by statute but have achieved meaning through the caselaw.

Under the Countryman test,¹⁶ a contract is said to be executory if:

The obligation of both the bankrupt and the other party to the contract are so far unperformed that the failure of either to complete performance would constitute a material breach excusing the performance of the other.

¹⁶ CN. Pickerill, 'Executory Contracts Re-Visited' (2009) 83(1) *American Bankruptcy Law Journal* 63.

The test has subsequently been refined over the years, but section 365 of the Code essentially boils down to the consideration of whether the contract is an unperformed one *vis-a-vis* obligations pending by both parties; and if so, whether any failure to perform those outstanding obligations would result in a breach of contract.

The contracts in question may thus be assumed, rejected or assumed and assigned by the trustee or debtor-in-possession.

It is the debtor who has the right to decide whether to agree to perform or refuse to perform the obligations under the executory contract to the exclusion of the counterparty but must make such a decision by the date of confirmation of its reorganization plan.

A deadline can be imposed by the bankruptcy court or the counterparty who must then show cause.

The only exception here is the decision about unexpired leases of non-residential property which are required to be made within 120 days of the order.

In considering whether the debtor rejected or assumed a contract fairly so, the court will consider whether the decision has been made in good faith or on the reasonable exercise of business judgment. The court will only deny approval of the election in situations where it was not made in good faith or reasonable exercise of judgment.

If the debtor rejects the contract the debtor constructively breaches the contract before the petition date. An unsecured creditor in this instance has a pre-petition claim for damages.

If the contract is assumed by the debtor it must be assumed in its entirety. The debtor cannot assume the contract or lease unless the debtor can provide adequate assurances that he will cure the default and carry out future performances. If subsequent to this the debtor rejects the contract the creditor has a claim for a post-petition administrative expense of the estate.

If the contract is assumed and assigned the debtor's rights are transferred to a third party who must then give adequate assurances of future performances.

The contract may be deemed assumed in certain circumstances such as where the debtor continues to occupy leased property.

The bankruptcy code abrogates contractual restrictions to enable the debtor to achieve a higher value for its assets.

Counterparty consent is only required on a contract for a loan or accommodation, or where substantive non-bankruptcy law (such as intellectual property law) provides that a counterparty cannot be compelled to accept performance from a third party.

In some rulings, courts have applied a hypothetical test and held that a debtor cannot assume an executory contract that it would be impermissible to assign. Other courts have applied an actual test and found that the provisions apply only in cases where the debtor intends to assign the contract.

To the debtor's credit, the opening of Chapter 11 proceedings heightens the ability of the debtor to assign contracts increases by the fact that *ipso facto* clauses which permit termination in the event of an insolvency or bankruptcy proceeding are nullified. But where performance is still lacking post-petition, the counterparty is entitled to terminate the contract after applying for relief from the automatic stay.

APPLICATION OF THE FACTS TO THE LAW

To determine whether the debtor can or should reject or assume a contract depends upon a weighing of the benefits to be gained from the decision to assume or reject and the costs of doing the same.

In as far as the breach of contract goes, if a debtor has prepetition contracts, it can reject those contracts, and the non-debtor counterparty will have an unsecured claim for damages, the same as if the debtor had breached the contract before filing for bankruptcy. The contract is not void so the counter party can retain anything received under the contract before the Chapter 11 petition was filed.¹⁷

Oil Corp's contract must be determined to be executory before section 365 can take effect. On application of the facts, it may be that performance being payment and delivery have been effected; thus the contract may not be said to be executory.

Alternatively, if it is found that the contract is executory then Oil Corp can use section 365 to reject the contract. Tactically, this may prove a better option for Oil Corp who will be able to demote ShipCo's claim to that of an unsecured creditor.

The investigations surrounding the illegal purchase of oil would have no effect on the opening of Chapter 11 proceedings, as that would be a separate criminal matter.

The opening of Chapter 11 proceedings brings into effect the worldwide moratorium and automatic stay on creditor action and enforcement, until relief from the stay is sought. Therefore, the foreclosure of the loan by the USA bank is stayed and USA Bank cannot execute on it, unless with leave of the court.

The eviction is also stayed pending the confirmation of the reorganization plan. The debtor is deemed to have assumed the contract if no election has been made by that time. If assumed, the debtor must perform on the outstanding obligation, which is to make payment on the outstanding rental or give adequate assurances regarding future payments. If Oil Corp subsequent to assuming the contract, defaults on those assurances, then the landlord has a claim for post-petition expenses paid out of the administration of the estate.

Question 4.3 [6 marks]

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?

ISSUE

The issues are:

- (i) Whether Oil Corp requires the consent of Plastic Corp to assume and assign the trademark license "Interconnect"?
- (ii) Whether it can reject the patent licenses without the consent of Plastic Corp? and,
- (iii) Whether it can sell the manufacturing facility free of the USA Bank lien?

¹⁷ *Ibid.*

Commented [H(52): The prepetition litigation over the claim would be stayed.

Commented [H(53): Partially correct, 1/2 mark, the criminal investigation is subject to a specific exception to the automatic stay

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LAW

Introduction

A 363 sale refers to the sale of a debtor's assets under section 363 of the US Bankruptcy Code. Section 363 of the Code provides for sale of assets outside the ordinary course, free and clear of all liens and other interests with court approval.

The sale enables debtors to fulfil their obligations to creditors by selling their assets and using the funds collected to settle their debts.

A debtor can also transfer its interests in key contracts that are required to operate the business even where they contain contractual restrictions on assignment or purport to terminate upon filing of a bankruptcy.

Licenses of patents and copyrights owned by the debtor are protected such that their licences may not be terminated in connection with the sale of the intellectual property without their consent.

Advantages

The debtor-in-possession controls the disposal of assets under the protection of the bankruptcy court, which grants the debtor the power to control the deal terms offered during a bidding auction.

The purchasers of the assets benefit from the opportunity to acquire valuable assets that are free of liens, claims, or other encumbrances – often at discount prices.

In addition, such sale is likely to be higher than would otherwise be received due to the fact that the business may continue operations whilst under bankruptcy proceedings.

Such a sale is preferable to an out-of-court sale because the purchaser who purchased the property in good faith may be entitled to retain its possession irrespective of a reversal of the court's decision on appeal.

Process

The debtor must establish the proposal of a section 363 sale of its property in its business judgment and it must indicate that such sale is to the benefit of the estate as a whole. This is done because of the fiduciary duty owed by the debtor to the creditors.

The debtor-in-possession attracts buyers for the property through marketing. If there are several interested purchasers, the debtor settles on the highest bidder to act as the stalking horse bidder. This bidder's price works as the base price for the auction bids, and the other bidders will use this bid as a benchmark.¹⁸

The price offered by the stalking horse bidder is the reserve price at which the property will be sold for at an auction i.e. the property cannot be sold for less than the stalking horse's bid. This mechanism is designed to protect the debtor from receiving a low return.

In exchange for the time and investment outlaid by the stalking horse bidder, the stalking bidder is offered certain perks.¹⁹

A creditor holding security in a property may "credit bid" and by use of this method create a market for secured creditors in the estate.

Subsequent to negotiations, the agreement between the debtor-in-possession and the stalking horse bidder is reduced to writing and filed at court for the court approval for the sale of assets at an auction commissioned by the court.

¹⁸ "363 Sale," available online at <https://corporatefinanceinstitute.com/resources/knowledge/deals/363-sale/>. Accessed 8th July 2022. "Corporate Finance."

¹⁹ For example the stalking horse bidder may be offered breakup fees, reimbursement of certain expenses, or favourable bidding terms.

Once the sale is approved by the court pursuant to the said auction, parties may still object to the sale stating their reasons for their objections. Some reasons could include that the marketing process was not a robust one, or that the purchaser is an insider. If substantially all the debtor's assets were sold, known as a *sub rosa* plan, this may also form a basis of an objection.

The bankruptcy court reserves the right to approve or reject the sale of assets. One of the reasons for seeking court approval of the sale is for the court to rule that the sale of assets was for "fair consideration", and thus reduce the risk of a fraudulent conveyance challenge. If the court rules that the asset sale was made in "good faith", that ruling offers the asset sale protection from a possible reversal on appeal.²⁰

In *Krys v. Famum Place, LLC (In re Fairfield Sentry Ltd)* 539 BR 658 the court held that a bankruptcy court must independently analyze a proposed sale under section 363 and must expressly find a good business reason to approve such sale. The court must not defer to approval of sale in foreign proceeding.

APPLICATION OF THE LAW TO THE FACTS

Oil Corp has invented several patented processes for plastic manufacturing, which it licenses to Plastic Corp. It does not need the consent of Plastic Corp to assume and assign the trademark license as Oil Corp is the licensor.

Under section 363 (f) of the Code, "the trustee may sell propertyfree and clear of any interest in such property of an entity other than the estate, only if—
(1) applicable non-bankruptcy law permits sale of such property free and clear of such interest;
(2) such entity consents.."

Therefore, applying the above, licensees of patents and copyrights owned by the debtor are protected such that their licences may not be terminated in connection with the sale of the intellectual property without their consent. Consequently, Oil Corp may not reject the patent licences without the consent of Plastic Corp.

Oil Corp is entitled under section 363 to sell assets free and clear of liens so Oil Corp is at liberty to pursue a section 363 sale herein without the consent of either the USA Bank or Plastic Corp.

Oil Corp however should take care to ensure that it complies with due process and conducts the negotiations leading up to the auction in good faith to ensure that no objections raised lead to a reversal of the sale.

This is because despite any approvals of any sales, the court is enjoined to independently analyze the agreement.

*** End of Assessment ***

²⁰ Corporate Finance note 18 above.

Commented [H(57): Incorrect, the trademark is licensed from Plastic Corp, so its consent is required to assign the license under trademark law

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Commented [H(59): Correct, 1 mark

Commented [H(60): Correct, 1 mark, though the lien will attach to the proceeds