



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 43/50

QUESTION 1 (multiple-choice questions) [10 marks in total]

Commented [H(2): Total marks 9/10

Questions 1.1. – 1.10. are multiple-choice questions designed to assess your ability to think critically about the subject. Please read each question carefully before reading the answer options. Be aware that some questions may seem to have more than one right answer, but you are to look for the one that makes the most sense and is the most correct. When you have a clear idea of the question, find your answer and **mark your selection on the answer sheet by highlighting the relevant paragraph in yellow**. Select only **ONE** answer. Candidates who select more than one answer will receive no mark for that specific question.

Question 1.1

Commented [H(3): Correct, 1 mark

ABC Corp is filing for bankruptcy under chapter 11. Which of the following **is not** a party in interest in that proceeding?

- (a) A neighboring land owner who has leased equipment to ABC Corp.
- (b) ABC's government regulator.
- (c) A bank that has loaned money to ABC.
- (d) A local advocacy group.**
- (e) All of the above.

Question 1.2

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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

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Which of the following statements about "pre-packs" is **false**?

- (a) A pre-pack cannot be used if the debtor wishes to reject executory contracts.
- (b) Creditors must have sufficient information about the debtor and the plan to make an informed voting decision.
- (c) A pre-pack debtor may spend as little as a single day in bankruptcy.
- (d) The proposed plan of reorganization is submitted to the bankruptcy court together with the voluntary petition.
- (e) Creditors' commitment to vote in favor of the plan may be memorialized in a restructuring support agreement.

Question 1.5

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

- (a) If one insider creditor approves of the plan of reorganization, all other impaired classes may be crammed down.
- (b) Because cramdowns do not require the consent of all classes, the plan of reorganization may not be fair and equitable to all impaired classes.
- (c) Differential treatment of different classes is permitted if there is a reasonable, good faith basis for doing so and such treatment is required for the plan of reorganization to be successful.
- (d) Class definition is rarely a battleground when a debtor tries to cramdown classes.
- (e) Dissenting creditors are not permitted to challenge the classification of a creditor supporting the cramdown.

Question 1.6

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

- (a) The exclusivity period is 1 year.
- (b) The exclusivity period cannot be extended.
- (c) The exclusivity period cannot be shortened.

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

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

Question 1.7

Commented [H(9)]: Correct, 1 mark

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

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

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

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

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

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

Question 1.8

Commented [H(10)]: Correct, 1 mark

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

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

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

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

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

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

Question 1.9

Commented [H(11)]: Incorrect, the correct response is (e)

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

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

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

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

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

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

Question 1.10

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

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

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QUESTION 2 (direct questions) [10 marks]

Commented [H(13)]: Total marks 6/10

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 for bankruptcy is one commenced by the debtor. Such voluntary petitions can be commenced under any chapter (i.e. chapters 7, 11 or 15).

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An involuntary petition for bankruptcy is one commenced by a creditor against an eligible debtor. It should be noted that involuntary petitions for bankruptcy may only be commenced under chapters 7 or 11 and cannot be commenced against a farmer, family farmer, or not-for-profit corporation.

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Question 2.2 (2 marks)

Commented [H(17)]: Total marks 1/2

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

Two potential consequences of a violation of the automatic stay include the requirement of the violator to:

1. Satisfy payment of the debtors' attorneys' fees; and,
2. Take the necessary steps to return the bankruptcy estate's property to its *status quo*.

Commented [H(18)]: Partially correct, 1/2 mark, this would be in the nature of contempt sanctions

Commented [H(19)]: Partially correct, 1/2 mark, this is because the act is void or voidable depending on the circuit

Question 2.3 (3 marks)

In what circumstances is a claim considered "impaired"? When is a holder of an impaired claim not entitled to vote on a proposed plan of reorganization and what happens instead?

A claim is considered "impaired" if the original debt terms are amended negatively in a reorganization plan such as by reducing the amount the creditor would have received in the original agreement or by increasing the repayment period.¹

In general, assuming all the requirements of confirmation of a reorganization plan are met, if all impaired class accept the plan, the court will confirm the plan. However, in the scenario where there are dissenting impaired classes, the plan may still be confirmed by "cramming down" such classes. To successfully cramdown impaired classes, in addition to meeting the above-mentioned requirements of confirmation, at least one impaired class must vote in favour of the plan.

Insider impaired classes are not entitled to vote for the purposes of cramdown. Instead, such votes are disregarded to determine whether an accepting non-insider impaired class exists. If at least one non-insider impaired class votes in favour of the plan, it must also be shown that the plan is fair and equitable to the dissenting impaired classes.

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?

1. Preferences

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

1. Preferences to third parties; for preferences to insiders, there is no presumption of insolvency
2. Actual fraudulent conveyances
3. Constructive fraudulent conveyances

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

1. Actual fraudulent conveyances

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

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

Commented [H(22)]: Incorrect, they vote but the votes are disregarded. Impaired claims that will receive nothing are not entitled to vote and are deemed to reject the plan

Commented [H(23)]: Total marks 2/3

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

Commented [H(25)]: The correct answer is preference, and while the debtor is not presumed insolvent in the 1 year look back period, it must be proved to have insolvent as stated in the question

Commented [H(26)]: Correct, 1 mark

¹ Geilich, Paul, "Impaired Creditors and Your Chapter 11 Bankruptcy Plan", at <https://www.lawyers.com/legal-info/bankruptcy/commercial-bankruptcy/impaired-creditors-and-your-chapter-11-plan.html>, accessed 4 May 2022.

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

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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?

28 U.S.C. § 157 provides that bankruptcy judges may hear and determine all “core” proceedings but not “non-core” proceedings. 28 U.S.C. § 157(b)(2)(C) includes as a category of “core” proceedings “counterclaims by the estate against persons filing claims against the estate”.²

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

In *Stern v Marshall*, a bankruptcy claim was filed against the debtor who then filed a counterclaim. Pursuant to 28 U.S.C. § 157(b)(2)(C) mentioned above, the Bankruptcy Court concluded that the counterclaim was a “core” proceeding and eventually awarded the debtor for damages on the counterclaim. This was appealed to the District Court which affirmed the Bankruptcy Court’s decision.³

Prior to the debtor’s bankruptcy, the debtor filed a suit against the claimant in Texas state court covering, amongst other things, the issues in the counterclaim. Prior to the District Court’s affirmation of the Bankruptcy Court’s decision, the state court conducted a jury trial and entered a judgement in favour of the claimant. As a result, the Court of Appeals ultimately reversed the Bankruptcy Court’s award on the basis that the Bankruptcy Court lacked authority to make final judgement on the counterclaim.⁴

Despite the Bankruptcy Court having statutory authority to enter judgement on a debtor’s counterclaim, the US Supreme Court found that it was unconstitutional to do so over a state law claim. In such cases (i.e. “core” proceedings over which the Bankruptcy Court lacks constitutional authority), the Bankruptcy Court would only be able to submit proposed findings of fact and conclusions of law as it would in “non-core” proceedings pursuant to 28 U.S.C. § 157(c)(1).⁵

Commented [H(30)]: Correct, 1 mark, specifically because this invades Article III jurisdiction. The Bankruptcy Court may issue a final order on a challenge to a petition or on a core proceeding with the consent of the parties

Question 3.2 (3 marks)

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

What provisions of the Bankruptcy Code may not be invoked by a foreign representative in a chapter 15 proceeding? What are two ways that the foreign representative can obtain equivalent relief?

The provisions of the Bankruptcy Code relating to avoidance powers / actions may not be invoked by a foreign representative in a chapter 15 proceeding.

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Two ways that the foreign representative can obtain equivalent relief include:

1. Pursuing any cause of action available under applicable foreign and non-bankruptcy law, including state law avoidance actions⁶; and,

Commented [H(33)]: Correct, 1 mark

² 28 USC, § 157.

³ Legal Information Institute, “*STERN v. MARSHALL (No. 10-179) 600 F. 3d 1037, affirmed.*”, at <https://www.law.cornell.edu/supct/html/10-179.ZS.html>, accessed 11 June 2022.

⁴ *Ibid.*

⁵ 28 USC, § 157.

⁶ Rosenblatt, Andrew and Copeland, James, “Chapter 15: Pursuing “Avoidance Actions” Under Nonbankruptcy Law”, at <https://www.nortonrosefulbright.com/en-us/knowledge/publications/ae70969d/chapter-15-pursuing-avoidance-actions-under-nonbankruptcy>

2. Commencing a plenary proceeding under the Bankruptcy Code, such as chapter 7 or 11, after recognition of the foreign proceeding under chapter 15. Through such chapters, the foreign representative would gain access to the Bankruptcy's Codes avoidance powers / actions.⁷

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

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?

Commented [H(35)]: Total marks 4/4

Final orders address and resolve *all* issues and claims, leaving nothing further to be determined, while interlocutory orders address and resolve only *some* of the issues and claims.

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

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

Final orders may be appealed as of right which means that leave (i.e. permission) from the appellate court is not required to commence the appeal. Conversely, interlocutory orders may only be appealed with leave from the appellate court.

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

Generally, appeals from bankruptcy court orders are heard by the applicable district court. However, in certain circuits, Bankruptcy Appellate Panels have been formed through which such appeals are heard although the appellant or any other relevant party has the right to request that the appeal be heard by the district court instead.

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

It should be noted that pursuant to 28 U.S.C. § 158(d), appeals from bankruptcy court orders may be heard directly by the court of appeals if one of the following conditions are met and if the court of appeals authorizes the direct appeal:⁸

1. the judgment, order, or decree involves a question of law as to which there is no controlling decision of the court of appeals for the circuit or of the Supreme Court of the United States, or involves a matter of public importance;
2. the judgment, order, or decree involves a question of law requiring resolution of conflicting decisions; or
3. an immediate appeal from the judgment, order, or decree may materially advance the progress of the case or proceeding in which the appeal is taken.

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?

Directors of Delaware corporations owe the following fiduciary duties:

1. Duty of **loyalty** (to the corporation's best interest); and,
2. Duty of **care** (in educated decision-making).

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

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

[law#:~:text=The%20bankruptcy%20court%20found%20that,under%20nonbankruptcy%20law%2C%20includin g%20state](#), accessed 11 June 2022.

⁷ 11 USC, § 1523.

⁸ 28 USC, § 158.

In the ordinary course of business, directors owe such duties to:

1. The corporation; and,
2. The corporation's shareholders.

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

When the corporation is potentially or actually insolvent, this does not change. That is, the directors continue to owe duties of loyalty and care to the corporation and its shareholders irrespective of the corporation's solvency status.

For completeness, in *North American Catholic Educ. Programming Found., Inc. v. Gheewalla*, the court established that irrespective of a corporation's solvency status, individual creditors cannot assert direct claims for breach of fiduciary duty against directors. However, the court made clear that creditors still have the option to bring derivative claims against the directors on behalf of the corporation for breach of fiduciary duty.⁹

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

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Question 4.1 [4 marks]

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

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

English Schemes of Arrangement of Foreign Companies

English courts will sanction an English scheme of arrangement of the creditors of a foreign company if it can be shown that:¹⁰

1. the foreign company has "sufficient connection" with England; and,
2. the scheme will achieve a "substantial effect" in the foreign jurisdictions in which the company conducts significant business.

One of the ways to show "sufficient connection" with England is where the finance documents (and therefore the rights of creditors) are governed by English law.¹¹ Gambling Corp's bonds are governed by English law and would likely satisfy the "sufficient connection" requirement.

In respect of "substantial effect", assuming that the requisite approvals in each class of creditor is obtained, expert evidence showing that the scheme would likely be recognized in Greece (i.e. Gambling Corp's place of incorporation and one of its business operations) and the United

⁹ Jones Day, "Delaware Supreme Court Limits Scope of "Zone of Insolvency" Fiduciary Duties", at <https://www.jonesday.com/en/insights/2007/10/delaware-supreme-court-limits-scope-of-zone-of-insolvency-fiduciary-duties>, accessed 11 June 2022.

¹⁰ Craggs, Mark and Thorn, Matthew, "Review of jurisdictional issues in recent cross-border schemes of arrangement", at <https://www.nortonrosefulbright.com/en/knowledge/publications/87824a8c/review-of-jurisdictional-issues>, accessed 12 June 2022.

¹¹ *Ibid.*

States (i.e. one of Gambling Corp's places of business operations) would satisfy this requirement.¹²

For completeness, the location of a company's Centre of Main Interests ("COMI") does not play a direct role in the English courts' approval of a scheme of arrangement.¹³

Chapter 15 Recognition of English Schemes of Arrangement

The following points need to be satisfied to obtain chapter 15 recognition:¹⁴

1. A debtor is subject to a "foreign proceeding";
2. A "foreign representative" is empowered to file a chapter 15 petition; and,
3. Likely the requirement for the debtor to show connection to the US in the form of a residence, domicile, place of business or assets in the US.

In respect of point 1, pursuant to 11 U.S.C. § 101(23), a "foreign proceeding" means "a collective judicial or administrative proceeding in a foreign country, including an interim proceeding, 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 reorganization or liquidation".¹⁵ This definition has been interpreted as encompassing English schemes of arrangement which have been granted chapter 15 recognition.

In respect of point 2, pursuant to 11 U.S.C. § 101(24), a "foreign representative" means "a person or body, including a person or body appointed on an interim basis, authorized in a foreign proceeding to administer the reorganization or the liquidation of the debtor's assets or affairs or to act as a representative of such foreign proceeding".¹⁶ In *Re Avanti Communs. Grp. PLC*, an English scheme of arrangement was sanctioned and a foreign representative was appointed to facilitate a chapter 15 recognition application.¹⁷ Therefore, in the case of Gambling Corp., a foreign representative could be appointed to satisfy this requirement.

In respect of point 3, Gambling Corp. would satisfy this due to it having business operations in Las Vegas.

Foreign Main / Non-Main Proceeding

A foreign proceeding can be recognized as either "main" or "non-main". A foreign "main" proceeding is a "foreign proceeding" pending in the country where the debtor has its COMI. A

¹² *Ibid.*

¹³ *Ibid.*

¹⁴ Kampfner, Roberto, Olier, Jonathan, McConnell, Charles and Ho, Joann, "US Chapter 15: Recognition of Indonesian Reorganization Plan", at <https://www.whitecase.com/publications/alert/us-chapter-15-recognition-indonesian-reorganization-plan#:~:text=Recognition%20of%20foreign%20proceedings%20under%20Chapter%2015&text=Chapter%2015%20governs%20the%20provision,direct%20appropriation%20by%20individual%20creditors.>, accessed 12 June 2022.

¹⁵ 11 USC, § 101.

¹⁶ *Ibid.*

¹⁷ Lowenthal, Daniel, "Chapter 15: US Court Respects UK Scheme of Arrangement: Third-Party Releases Enforced", at <https://www.pbwt.com/bankruptcy-update-blog/chapter-15-us-court-respects-uk-scheme-of-arrangement-third-party-releases-enforced>, accessed 12 June 2022.

foreign “non-main” proceeding is a “foreign proceeding” pending where the debtor has an establishment.¹⁸

COMI is not defined in Chapter 15 however, the location of the debtor’s registered office is presumed to be its COMI. This presumption is rebuttable based on other facts including the location of the debtor’s headquarters, those who manage the debtor, and the debtor’s assets.¹⁹ In the case of Gambling Corp., its registered office and principal place of business is located in Greece. As such, Greece would be considered its COMI; an English scheme of arrangement of Gambling Corp. would be ineligible to be recognized as a “main” proceeding.

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

Pursuant to 11 U.S.C. § 1502(2), an “establishment” means “any place of operations where the debtor carries out a nontransitory economic activity”.²⁰ Gambling Corp. has business operations in London which would be considered an establishment for the purposes of chapter 15 recognition. As such, the English scheme of arrangement would be eligible to be recognized as a foreign “non-main” proceeding in a chapter 15 recognition application.

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

Question 4.2 [5 marks]

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

Upon the filing of a chapter 11 petition by Oil Corp, a worldwide automatic stay would be invoked with respect to any proceeding against it or its property as it relates to any pre-petition claims subject to certain statutory exceptions.

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Situation 1

In situation 1, ShipCo 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. The automatic stay relates to the commencement or continuation of litigation on pre-petition claims.²¹ As such, the lawsuit filed by ShipCo would be suspended upon the filing of the chapter 11 petition by Oil Corp.

Commented [H(56)]: Correct, 1 mark

¹⁸ Vazquez, Francisco, “Overview of the key Chapter 15 decisions in 2020”, at <https://www.nortonrosefulbright.com/en/knowledge/publications/1496f7a8/key-chapter-15>, accessed 12 June 2022.

¹⁹ *Ibid.*

²⁰ 11 USC, § 1502.

²¹ Smith, Aaron and Kind, Michael, “Locke Lord QuickStudy: The Use of Chapter 11 of the Bankruptcy Code to Address Business Disruption Resulting From COVID-19”, at <https://www.lockelord.com/newsandevents/publications/2020/03/the-use-of-chapter-11-covid19#:~:text=A.&text=The%20automatic%20stay%20bars%20the,before%20commencement%20of%20the%20case,> accessed 23 June 2022.

Situation 2

In situation 2, the US Department of Justice (“the DoJ”) is investigating whether Oil Corp illegally purchased oil from countries subject to US sanctions. One of the statutory exceptions to the automatic stay is regulatory investigations. Therefore, the filing of the chapter 11 petition would not impact, suspend or otherwise limit the DoJ’s ongoing investigations into Oil Corp’s potential illegal activities.

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Situation 3

In situation 3, USA Bank is threatening to foreclose on an Oil Corp refinery located in the Philippines due to the default of a secured loan. The automatic stay prohibits foreclosures on a debtor’s property. The worldwide nature of the automatic stay would include Oil Corp’s refinery despite it being located in the Philippines.

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

Situation 4

In situation 4, Oil Corp’s landlord in Houston, Texas is threatening to evict it due to a missed rent payment. One of the statutory exceptions to the automatic stay is eviction by a landlord from commercial property where the lease has expired. In this case, it appears that the lease is still valid. As such, the automatic stay would work in Oil Corp’s favour and prohibit the landlord from:²²

1. commencing eviction actions;
2. continuing an unfinished eviction action;
3. attempting to collect past-due rent; or,
4. using a security deposit to offset amounts owed to the landlord by the tenant.

Commented [H(59)]: Correct, 1 mark

²² McGill Gotsdiner Workman & Lepp PC LLO, “What Commercial Landlords Need to Know if a Tenant Files a Chapter 11 Bankruptcy (And What They Should Consider Before the Filing)”, at <https://www.mgwl.com/blog/what-commercial-landlords-need-to-know-if-a-tenant-may-file-a-chapter-11-bankruptcy/>, accessed 23 June 2022.

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?

Condition 1

Oil Corp thinks it will get the highest return for the plastics manufacturing business if it can assume and assign the trademark license. However, trademark licenses are not assignable without the consent of the licensor. In this case therefore, Oil Corp would have to first obtain Plastic Corp's consent to assume and assign the trademark license before being able to do so.

Condition 2

Oil Corp thinks it will get the highest return for the plastics manufacturing business if it can reject the patent licenses so the purchaser has the exclusive right to use the patents. 11 U.S.C. § 365(n) provides that such rejections may not occur without the consent of the licensee.²³ Therefore, Oil Corp would have to first obtain Plastic Corp's acceptance and consent to the rejection and termination of the patent licenses before being able to grant the purchaser exclusive right to use the patents.

Condition 3

Oil Corp thinks it will get the highest return for the plastics manufacturing business if it can sell the manufacturing facility free and clear of the USA Bank lien.

Such a sale can be achieved with court approval pursuant to 11 U.S.C. § 363 of which the following is relevant to this condition:²⁴

1. 11 U.S.C. § 363(f) provides that, amongst other things, prior to court approval of such a sale, USA Bank would have to consent to the sale or Oil Corp would have to demonstrate that the sale proceeds would be greater than the secured claim and therefore be sufficient to satisfy the claim in full.
2. 11 U.S.C. § 363(m) provides that the reversal or modification of court approval would not affect the validity of the sale to a good faith purchaser unless the sale was stayed pending appeal. This is an attractive provision to potential purchasers of the manufacturing facility as they can gain comfort that the free and clear sale would be final barring any stay granted pending appeal.

²³ 11 USC, § 365(n).

²⁴ 11 USC, § 363.

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3. Pursuant to 11 U.S.C. § 363(k), USA Bank would be permitted to bid on such sale and if the bid is ultimately accepted, USA Bank may offset the secured claim against the purchase price of the manufacturing facility. In the scenario where adequate or acceptable bids on the manufacturing facility were not received or consented to by USA Bank, this provision provides Oil Corp with an additional option of selling directly to USA Bank in full satisfaction of the secured claim.

It should be noted that often, in cases involving significant sales such as this one with the manufacturing facility, an initial auction would be held prior to bankruptcy to identify the highest and best bid. The winning bidder is referred to as the “stalking horse” bidder and sets the “floor” for the subsequent auction held during the bankruptcy case, pending court approval. Upon the conclusion of the subsequent auction, Oil Corp would then select the highest and best offer and seek court approval of such bid. The closing of the sale will occur once court approval of the sale is obtained.²⁵

*** End of Assessment ***

²⁵ Baker & McKenzie, “A Road Map for Potential Buyers of Distressed Businesses in Section 363 Bankruptcy Sales”, at <https://restructuring.bakermckenzie.com/wp-content/uploads/sites/23/2020/04/Road-Map-for-Potential-Buyers-of-Section-363-Bankruptcy-Sales.pdf>, accessed 24 June 2022.