



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 10/10

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

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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

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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?

A voluntary petition is a petition that is filed by a debtor for the commencement of insolvency proceedings. A list of assets and creditors is usually filed with the petition although if absent (naked) would still be sufficient to invoke an automatic stay and commence insolvency proceedings. The debtor need not claim to be insolvent to commence proceedings.

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On the other hand, an involuntary petition is usually commenced by creditors against eligible debtors. The involuntary petition is commenced under chapter 7 or 11 of the Bankruptcy code and cannot be commenced under any other code or against farmers, family farmer or non-profit organizations. If a debtor has more than 12 non-contingent, non-insider creditors then at least three qualifying creditors is required to join the petition. However, if it has less than 12 non-insider creditors, only one is required to file the petition. There are various requirements to be met for a creditor to be qualified as a petitioning creditor. The creditor must have a claim against the debtor that is non-contingent, that is not the subject of a bona fide dispute as to liability or amount and that is unsecured or undersecured, separately or in aggregate with all other petitioning creditors' claims, in the amount of at least USD 15,775 (this amount is periodically increased due to inflation). An involuntary petition form requires an allegation of insolvency and required the petitioning creditors to allege: (1) the debtor is generally not paying its debts as they become due, unless they are subject of a bona fide dispute as to liability or amount or that, "within 120 days before the filing of this petition, 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)

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

Two potential consequences of a violation of the automatic stay are (1) contempt of court and (2) the act would be deemed void or voidable. Where a party has committed contempt of court, the party may be subject to contempt violations which may include paying a daily fine

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into Court until the contempt is rectified, payment of the debtor's attorney's fees or requiring the violator to take affirmative acts to undo the effects of its violation.

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?

1. A claim is considered impaired where the plan alters the legal, equitable and contractual rights to which such claim or interest entitles the holder of such claim or interest of a class of creditors.
2. When the holder of impaired claim will not receive any distribution under the plan of reorganization, they deemed to have rejected the plan of reorganization and, therefore, do not vote.

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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?

The cause of action that would apply here is preferences.

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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?

The cause of action that would apply here is preferences.

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

The cause of action that would apply here is actual fraudulent conveyance.

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

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Question 3.1 (3 marks)

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

Before the decision of *Stern v Marshall*, it was accepted principle that bankruptcy court had jurisdiction to grant final orders in respect of core matters. However, the Supreme Court ruled in this case that the bankruptcy court cannot issue final orders that invade Article III jurisdiction.

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Since this order, there have been amendments to the Bankruptcy Rules. As a result of this case, the US Supreme Court have also held that bankruptcy judges may determine a core proceeding over which they lack constitutional authority by issuing a report and recommendation for review by the district court, the same procedure as in non-core proceedings, or, with the consent of the parties, may issue final orders. This case has also

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resulted in the implementation of Bankruptcy Rules which requires litigants to state in their pleadings whether they consent to the entry of final orders or judgment by bankruptcy court.

The Bankruptcy Rules have also implemented rules which permit district courts that determine whether a bankruptcy court has jurisdiction to enter a final order to treat its order as proposed findings of fact and conclusions of law.

Question 3.2 (3 marks)

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?

1. Foreign representatives are not entitled to invoke powers that a debtor in possession or trustee avoidance would use. This has been widely interpreted only to apply to the use of avoidance powers such as avoidance of preferences and fraudulent conveyance and not to bar a foreign representative from seeking to avoid pre-petition transactions under other applicable US or foreign law.
2. A foreign representative can commence plenary proceedings to obtain access to the Bankruptcy Code avoiding powers after the recognition of the foreign proceedings under chapter 15 or it can invoke the Bankruptcy Code avoidance powers in a plenary proceeding that was commenced by a debtor or creditor prior to its involvement.

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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?

1. Final orders are those that dispose of all issues, leaving nothing further to be decided whereas interlocutory orders only deal with some or one of the issues in the proceedings. Final orders may be appealed as of right where are interlocutory orders may be appealed only with leave of the appellant court.
2. Generally, appeals from bankruptcy court orders are heard by the district court for the district in which they sit. However, in some instances, appeals are heard by the Bankruptcy Appellant Court (BAP) which usually comprises of judges from the bankruptcy court in the circuit. A party in this circuit can request for the matter to be heard before the district court if the party so desires.

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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?

The directors of Delaware corporation owe a fiduciary duty of loyalty to Delaware corporations to act in the corporation's best interest and a duty of care in educated decision-making.

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The directors also have a duty to act in good faith and the best interest of the corporation. These duties are owed to Delaware corporation and the shareholders of Delaware corporation. These duties are not owed to creditors when the corporation is potentially insolvent or actually insolvent and are only owed to the Delaware corporations and its shareholders.

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In the case of *North Am Catholic Educational Foundation, Inc v Ghreewalla*, 930 A.2d 92, 103 (Del 2007), it was held that individual creditors of an insolvent corporation have no right to assert direct claims for breach of fiduciary duty against corporate directors.

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.

It has been established that English schemes of arrangement have been granted recognition as foreign main proceedings or foreign non-main proceeding unless they are manifestly contrary to US public policy. However, to determine whether the English scheme could be granted recognition under US chapter 15 as a foreign main or non-main proceeding, one must first consider the COMI of Gambling Corporation. As Gambling Corporation is incorporated in Greece and its principal place of business is in Greece, its COMI is presumed to be in Greece. Accordingly, the US Courts are likely to recognise the English scheme of arrangement as foreign non-main proceedings since Gambling Corporation has an establishment in London which operates casinos and betting parlors.

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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?

There will be a worldwide automatic stay of creditor enforcement proceedings against Oil Corp and its property which will provide breathing space for Oil Corp to continue its operations in the ordinary course of business and work with its key constituencies to propose a plan of reorganization to adjust to its debts. This plan of reorganization may be confirmed by the court (cramdown) without the approval of all its creditors. Therefore, the claim by ShipCo for a breach of contract lawsuit in Texas state court alleging that Oil Corp sold it contaminated oil

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that caused USD 1 billion in damage to ShipCo's container ships will be automatically stayed upon the filing of the chapter 11 petition.

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However, the US Department of Justice will continue to investigate whether Oil Corp illegally purchased oil from countries subject to US sanctions as a stay is subject to exceptions such as regulatory investigations and criminal proceedings.

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The stay also prohibits the creditors, US Bank from proceeding with any action for foreclosure of the Oil refinery and Oil Corporation can formulate a plan and negotiate with the USA Bank during the exclusivity period for the repayment of the loan.

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As it relates to the threat for eviction of Oil Corp from the office space in Houston Texas, if the lease has not expired an eviction would be in breach of the stay. However, the lessor of the office space can file a claim for pre-petition rent if it desires to be paid.

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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?

1. Oil Corp cannot simply assume and assign the trademark "Interconnect", which is licensed from Plastic Corp without Plastic Corp's consent, as trademarks are generally not assignable. The Bankruptcy code provides that the licensor cannot be compelled to accept performance of a transferee and as such the licensor must consent to the transfer of the assignor's rights to a third party. Therefore, before Oil Corp assume and assign "Interconnect" to a third party, it must first obtain consent from Plastic Corp.
2. Oil Corp cannot unilaterally reject the patent licenses to Plastic Corp so that the purchaser may have exclusive rights. The bankruptcy code provides special protection for patent licensees in the event that a patent licensor (debtor) files for bankruptcy. This allows the licensees to retain their rights under a patent license even if the patent owner enters bankruptcy and seeks to terminate the license. In the Supreme Court case of *Mission Product Holdings, Inc. v. Tempnology, LLC (Mission Product)* it was held that "rejection in bankruptcy operates like a typical contract breach and thus, the debtor cannot rescind the license already conveyed. So the licensee can continue to do whatever the license authorizes."
3. The Bankruptcy code provides that a debtor in possession in a chapter 11 proceedings can sell its property free and clear of creditors interests to a strategic purchaser or a successful corporate entity with court approval in a 363 sale and that a good faith purchaser may retain the property notwithstanding a subsequent reversal of court approval for the sale on appeal. Therefore, Oil Corp may sell the manufacturing facility free if its value exceeds the debt owed to the USA Bank without the USA Bank's consent. USA Bank will have a lien over the proceeds of sale in priority of other creditors.

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*** End of Assessment ***