



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

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

(a) A pre-pack cannot be used if the debtor wishes to reject executory contracts.

(b) Creditors must have sufficient information about the debtor and the plan to make an informed voting decision.

(c) A pre-pack debtor may spend as little as a single day in bankruptcy.

(d) The proposed plan of reorganization is submitted to the bankruptcy court together with the voluntary petition.

(e) Creditors' commitment to vote in favor of the plan may be memorialized in a restructuring support agreement.

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Question 1.5

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

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

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

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

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

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

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Question 1.6

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

(a) The exclusivity period is 1 year.

(b) The exclusivity period cannot be extended.

(c) The exclusivity period cannot be shortened.

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

Question 1.7

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

- (a) The automatic stay applies upon the filing of a petition for recognition.
- (b) A debtor cannot be subject to an involuntary chapter 15 proceeding.
- (c) A chapter 15 petition must be filed by a foreign representative.
- (d) The automatic stay applies only to property within the territorial jurisdiction of the United States.
- (e) Recognition may be granted to a foreign proceeding as either foreign main or foreign non-main.

Question 1.8

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

- (a) A 363 sale permits a debtor to sell an asset free and clear of encumbrances.
- (b) A creditor's lien on assets sold in a 363 sale attaches to the proceeds of the sale.
- (c) A 363 sale must be conducted as an auction with a stalking horse bidder.
- (d) Purchasers may pay a higher price for assets sold in a 363 sale than in an out-of-court transaction.
- (e) Sophisticated parties will insist on a 363 sale if there is any question regarding whether the sale is "in the ordinary course of business".

Question 1.9

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

- (a) The counterparty has a claim for damages for breach of contract.
- (b) The counterparty must immediately stop using the trademark.
- (c) The counterparty can continue using the trademark for the remaining period of the license.
- (d) Both (a) and (b).
- (e) Both (a) and (c).

Question 1.10

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

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

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QUESTION 2 (direct questions) [10 marks]

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Question 2.1 (2 marks)

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

The difference is that voluntary petitions will be commenced by a debtor while involuntary petitions will be commenced by a creditor. Voluntary petitions require no allegation that the debtor is insolvent and can be commenced under any applicable chapter of the Bankruptcy Code. Involuntary petitions on the other hand, require that the creditor allege that the debtor is generally not paying their debts when they fall due, or that a custodian can be appointed to take charge of substantially all of the debtor's property 120 days before the petition is filed. Involuntary petitions also can only be commenced under Chapters 7 and 11.

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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?

- a. Where the party in violation may be subject to contempt sanctions.
- b. Where the transaction in breach of the stay will be automatically void or it will be voidable. This is of course dependent on the circuit in which the bankruptcy proceeding is pending.

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Question 2.3 (3 marks)

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

The claim will be impaired where the legal, contractual or equitable rights of the claim holders within its class are altered. This is rule is based on sections 1123 and 1124 of the Code, and includes impairments such as reducing the claim holder's debt or delaying payment terms.

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An impaired claim that will receive nothing under the proposed plan of reorganization, do not vote and are deemed to reject the plan.

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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?

Preference.

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

Preference.

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

Actual fraudulent conveyance.

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

Question 3.1 (3 marks)

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

Prior to *Stern v Marshall*, the referral statute, 28 USC §157 and 1334, established the bankruptcy's court jurisdiction to grant final orders in core matters. The referral statute also had a non-exhaustive list of what could be considered core proceedings or core matters. *Stern v Marshall*, however, change the law when it was held that the bankruptcy court did not have jurisdiction or authority to enter final orders where the relevant matter fell within the jurisdiction of Article III of the Constitution (the jurisdiction of Federal Courts). This was even where the proceedings/matter was a "core matter". Any final order by the bankruptcy court would be unconstitutional.

After *Stern*, the practises in the courts changed so that bankruptcy courts now issue reports and recommendations which are reviewed by district courts. Bankruptcy courts also now invite parties to the proceedings to confirm at the start of the proceedings whether they consent to the court's order and judgment being entered as final. Finally, the court now may enter final orders on challenges to a petition.

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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?

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In accordance with SC § 1523(a), a foreign representative cannot invoke a debtor in possession's or trustee's avoidance powers in accordance with the Bankruptcy Code. This generally means that the foreign representative is restricted from pursuing preference and fraudulent conveyance transactions. It has been interpreted however, to not affect the foreign representative from commencing claims under other, non-bankruptcy, foreign laws.

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The foreign representative may, however, obtain equivalent relief by seeking to reverse pre-petition transactions by way of:

1. Using other applicable US law or laws if the country that they were originally appointed in; or
2. Opening separate plenary proceedings in the USA under the Bankruptcy Code. There is a very low threshold for commencing bankruptcy proceedings in the USA.

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Question 3.3 (4 marks)

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

Interlocutory orders are orders that only resolve / determine issues that arise within a bankruptcy proceeding. Final orders on the other hand, are orders that dispose of all issues in the proceedings with nothing left to decide.

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Commented [H(40)]: Correct, 1/2 mark

Final orders (as opposed to interlocutory), can be appealed as of right without leave of the appellate court. Leave is required in cases where the order is interlocutory. However, it has been held by the Supreme Court that an order that determines a discrete dispute in an insolvency proceeding should be considered a final order for the purposes of appeal (and the question of whether leave is required).

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Commented [H(42)]: Correct, 1/2 mark

In relation to which courts may hear direct appeals from bankruptcy court orders, this will depend on the circuit. In most circuits, the direct appeal will be to the district court of that circuit. In other circuits, the appeal may be referred to a Bankruptcy Appellate Panel. In the latter case, a party has the option to request that the appeal be heard by a district court / federal court instead.

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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?

In Delaware, directors owe duties to the corporation and to the corporation's shareholders. There is no duty to creditors, even when the company is in the 'zone of insolvency' or actually insolvent. These duties are enforceable, and include (a) the duty of loyalty to the corporation's best interest and (b) the duty of care in making informed decisions.

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While carrying out their roles, however, directors are entitled to rely upon what is known as the "business judgment rule". This rule creates a presumption that the directors acted in good faith based on reasonable information. The presumption does not apply where the directors are not disinterested and independent or where a shareholder with a controlling interest is on both sides of the transaction. As with all other presumptions, the presumption that the directors acted in good faith and upon reasonable u can be rebutted by evidence that a majority of the directors were not reasonably informed, did not honestly believe they were acting the corporation's best interest or were not acting in good faith.

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.

An English scheme of arrangement may be considered by Gambling Corp, as such arrangements are capable of being granted recognition under Chapter 15 as a 'collective judicial or administrative proceeding in a foreign country.' Whether the English scheme would be granted recognition as a foreign main or foreign non-main proceeding is dependent on whether the center of main interest (COMI) of Gambling Corp is England and Wales.

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Gambling Corp is incorporated in and has its principal place of business at Greece. There is therefore a presumption that its COMI is Greece. This presumption may, however, be rebutted and Gambling Corp may have evidence to show that England and Wales is its COMI, upon considering factors such as the location of assets, management etc (the London casino).

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If Gambling Corp fails to show that England and Wales is its COMI, the US would recognise the English scheme of arrangement as a foreign non-main proceedings as the casino in London would qualify as the necessary establishment.

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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?

Where Oil Corp files a Chapter 11 petition, it would get the benefit of an automatic worldwide stay, which would provide time to formulate and negotiate a restructuring plan with the initial 120 day exclusivity period.

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ShipCo's claim against Oil Corp would be stayed as it would constitute litigation on a pre-petition claim.

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The stay would not affect the US Department of Justice's investigations into whether Oil Corp illegally purchased oil from countries subject to US sanctions. This is because regulatory investigations are not subject to the worldwide stay.

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However, the stay would apply against the USA Bank's threat to foreclose on Oil Corp's refinery located in the Philippines. The automatic stay would apply against acts to obtain possession or control of the assets of Oil Corp. The stay would have worldwide application and so it would apply to the refinery although it is located outside the USA.

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Where the lease of the property in Houston is not expired, an eviction by the landlord would also constitute an act to obtain possession or control of the property of Oil Corp. The landlord would be in breach of the stay if he/she did so and would be liable to be found in contempt of court.

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Question 4.3 [6 marks]

Commented [H(63)]: Total marks 5/6

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?

(i) Oil Corp or its trustees will require the consent of Plastic Corp to assume and assign the trademark license. Trademark licenses are generally not assignable absent the consent of the licensor (i.e. Plastic Corp) under Federal trademark law, and this was confirmed in *Re Trump Entertainment Resort, Inc.*

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Commented [H(65)]: Correct, 1 mark

(ii) If it has filed a chapter 11 petition, Oil Corp or its trustees may not reject the license for the purpose of selling it to another party pursuant to 11 USC §365(n) and 1107(a) unless it obtains permission to terminate from the court. Oil Corp could reject the patent license if it was in Chapter 7 (and will be automatically deemed to do so if no decision is made by the trustee in 60 days of the petition date). If rejected, Plastic Corp would have a claim in damages against Oil Corp. While technically, the license could be rejected, Plastic Corp would retain the ability to use the patent for the duration of the license term under 364(n).

Commented [H(66)]: Correct, 1 mark, thus cooperation of Plastic Corp would be required to achieve exclusivity

(iii) As for the sale of the manufacturing facility – where the property value exceeds the level of the debt secured against Oil Corp, the facility can be sold without the USA Bank's consent pursuant to section 363(f) of the Bankruptcy Code. The USA Bank will then have a lien over the proceeds of sale of the facility and be paid those in priority to other creditors.

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Commented [H(68)]: Correct, 1 mark

*** End of Assessment ***