

Debtor-Creditor Final Exam - 1 Spring 1990 - Prof. Ferriell

CAPITAL UNIVERSITY LAW SCHOOL -- SPRING 1990
PROFESSOR FERRIELL -- DEBTOR-CREDITOR RELATIONS
FINAL EXAM

Instructions

1. This is a three (3) hour examination consisting of two essay questions of equal weight.
2. This exam will be counted as 70% of your grade for the course. Your grade for participation in the Debtor-Creditor Game will constitute 30% of your grade for the course as indicated in the syllabus. In order to preserve your anonymity for the final exam the Registrar will combine your grade on the exam with your grade in the game portion of the course in order to arrive at a final grade for the entire course.
3. You may have with you and use during the exam your copy of the casebook, West's Bankruptcy Statutes, and any notes or outlines prepared by you personally. You may not have other written materials.
4. Place your exam number on each blue book you use.
5. Indicate on the front of each bluebook the number of the question or questions you have answered in the bluebook.
6. You may leave the room during the exam if you need to because of illness (including nicotine addiction) or incipient incontinence. You must, however, leave all of your examination materials in the examination room. Failure to follow this instruction will result in my collecting your materials immediately and basing your grade on the answers you have written up to that time.
7. I will not answer any questions about the exam after it begins.
8. Good Luck

QUESTION I

Small Business Corporation is in serious financial difficulty. It has fallen seriously behind on its obligations to many of its suppliers and has not remitted payroll withholding or sales taxes to the appropriate authorities for the last several months. Three months ago it used all of its accumulated cash to make a payment to Mary Small. The \$60,000 payment to her was required under the terms of an agreement entered into over a year ago between SBC, George Small, and Mary Small, executed in conjunction with George and Mary's divorce, in redemption of her stock in the corporation.

Small Business Corporation's debts are:

\$3,000 overdue rent for the past two months on the commercial lease on its warehouse facilities. The monthly rent due is \$1,500. The landlord, Land Baron, Inc., sent a notice on April 31, 1990 indicating that if the back rent was not paid by May 5, that it would consider the lease terminated as of that date. The fair rental value of these premises is \$1,200 per month, and 6 months remain due on the lease.

\$100,000 to Merchant's State Bank, on a promissory note, secured by a recorded first mortgage on the land and building which constitute SBC's main manufacturing facility. Due to a downturn in the local economy, the land and building are worth only \$80,000.

\$30,000 to Big Equipment Corp., on a promissory note, secured by a perfected senior security interest on the debtor's equipment. This equipment is worth \$45,000.

\$20,000 on a promissory note to George Small, owner of 100% of the stock of Small Business Corporation, secured by a perfected junior security interest on the debtor's equipment.

\$3,000 to the IRS for payroll withholding taxes.

\$5,000 to the State Sales Tax Department for sales tax receipts.

\$10,000 in total unpaid vacation pay, accrued over the past one year period to 20 employees in the amount of \$500 each.

\$50,000 to six suppliers, (\$40,000 to one; \$2,000 to each of the remaining 5) none of whom are secured.

SBC's assets, in addition to the Land & Building and Equipment described above are Accounts Receivable worth \$30,000.

SBC has not yet filed a bankruptcy petition, but is likely to file soon if it cannot convince all of its creditors to agree to a out-of-court settlement that one large creditor (owed \$40,000 of the \$50,000 to unpaid suppliers) has proposed. Under the terms of the proposal SBC will pay the following:

\$80,000, plus market interest, to Merchant's State Bank, in equal monthly installments, over the next 15 years of \$860 per month.

\$30,000, plus market interest, to Big Equipment Corp., in equal monthly installments over the next 3 years of \$995 per month.

\$20,000, plus market interest, to George Small, in equal monthly installments over the next 5 years of \$450 per month.

\$30,000 cash, to be paid pro rata to the IRS, the State Sales Tax Department, Land Baron, Inc., Employees with vacation pay claims, and unpaid suppliers. This cash can be obtained from the sale of the accounts receivables.

SBC has income sufficient to make the payments required under this proposal, but would be unable to pay much beyond this amount.

Outside of bankruptcy court the agreement of all creditors is necessary for this proposal to effectively rescue SBC from its financial difficulties (a levy by any one creditor, no matter how small, would shut SBC's business down). The creditors can probably be persuaded to agree to the proposal if it is likely that it would be confirmed by a bankruptcy court despite their dissatisfaction.

DRAFT A MEMO EVALUATING WHETHER THIS PROPOSAL WOULD BE LIKELY TO BE CONFIRMED BY A BANKRUPTCY COURT IF SUBMITTED AS A CHAPTER 11 REORGANIZATION PLAN.

QUESTION II

During the past few years consumer debtors have made increasing use of what is being called "chapter 20" --- a liquidation under chapter 7 followed by an immediate chapter 13 rehabilitation plan.

Debtors most likely to use chapters 7 and 13 in this manner are reportedly those with discharge problems or those who want to dump the rest of his or her debt and concentrate on paying a secured loan (such as a house and car).

Thus far the circuit courts of appeal have found no problem with using the bankruptcy code in this way, despite the anti-debtor tilt evident in the circuit court opinions interpreting the substantial abuse test of 11 U.S.C. section 707(b).

Draft an amendment or amendments to the bankruptcy code designed to prevent the use of chapter 20 in this way and explain the arguments in support of and against your proposal. In drafting your proposal make sure that it balances the legitimate interests of debtors and creditors. Remember, legislation that is too one-sided is unlikely to pass - either in Congress or in this class.