

Bankruptcy

Summer 1986 Bankruptcy Final

Exam issue outline

Question 1

I. T avoidance powers of Trustee (Ch. 7)

A. T v. ABC (TV worth \$1,000)

1. 547(e)(3) says transfer does not take place until debtor has acquired rts. in the collateral. D. acquired rts. June well past 10 days after actual transfer (May 1, financing statement May 5)

a. Thus a preference since now within 90 days and a transfer on account of an antecedent debt.

2. But 547(c)(3) protects this transaction from avoidance since ABC filed within 10 days

a. so ABC is fully secured and can't be avoided under 522 (f) since a PMSI 9-207.

B. T v. M.M. (Boat worth \$2,000)

1. Once again 547(e)(2) says if perfection (good against lien creditors) does not take place within 10 days of actual transfer the transfer will be deemed to take place when interest is so perfected unless (PMSI in consumer goods) automatically perfected

a. Here that is May 15th - now transfer on account of antecedent debt

2. 547 (e)(3) does not protect since did not file within 10 days

a. 547(c)(1) contemporaneous exchange - cts split but ever if hold that it is applicable cts. generally require perfection within 10 days

3. The fact that Ark. gives a PMSI 21 days to perfect and thus temporary perfection under 9-301, will not help M & M 546 (b) which incorporates state law grace periods does not do so for 547.

a. so M & M unperfected and \$2,000 boat will pay off pro rata unsecured C's like M & M

C. T v. XYZ \$800 claim (Stereo worth \$1,000) and Dentist (claim \$500)

1. T can not avoid XYZ's interest because 547(c)(2) gives 10 days to perfect - done here (9 days) so transfer deemed to have taken place May 15th - so not a transfer on account of an antecedent debt also a (c)(1) contemporaneous exchange

2. Dentist's execution lien takes priority over XYZ since XYZ was unperfected (not a PMSI) when the lien arose

a. therefore dentist has \$500 over secured claim.

a. 506 (b) allows interest on such claims (no longer limited to voluntary transactions)

b. But not allowed attorney fees 506(b) only allow - costs and fees if arise under agreement

3. But lien arose within 90 days prior to bankruptcy so exec. lien can be avoided by T as a pref. 547 (b)

4. 551 allows T to step into Dentist's shoes so XYZ will still be junior and cannot benefit from the avoidance.

D. T v. Bea Brown and former wife (unimproved property)

1. 550 (b) protects Bea assuming she took for value, in good faith and without knowledge of the avoidability of the transaction.

2. But transfer to wife of D's @ interest in the Madison property may be fraudulent conveyance.

a. 548 now covers involuntary as well as voluntary transfers
b. D certainly received less than reas. equiv. value.

a. getting the divorce would not be value
c. but this transfer did not take place within 1 year of bank petition.

3. But T may be able to avoid under 544(b) and Ark.fraud. conveyance law which has a 3 year st. of lim.

a. need to prove insolvency at time of transfer but to a relative so may shift burden of proof

b. But Ark. is an "intent to hinder delay and defraud" Statute and so need elements of fraud not shown here

E. T. v. Ist Bank - foreclosure paid \$30,000 on a \$60,000 house

1. T can avoid as a fraud conveyance. Ist paid 50% of value and approx. 70% is required before a ct. will hold the bk. paid reason equiv. value

a. 548 (c) gives Ist a lien on house for value give \$30,000 lien.

2. Some cts. invalidate these foreclosures under 547 if the transfer takes place within the 90 day period as was the case here.

a. 547 has no protective section like 548(b) for value given so T may be able to invalidate and leave Ist totally unsecured. This seems unfair and the cts. that have been using 547 seem to be providing a lien for value given over though the statute does not provide such.

3. But even if avoided under 547, 550(d) will protect Ist for \$500 in taxes paid

F. T v. 2nd Bank and Mother (Bank account and jeep)

1. T cannot avoid 2nd's set off rts under 553(b) since the Bk. did not exercise its rt. to set off until post petition

2. T can prob. not avoid under 553(a)(3). D's clear purpose in making the deposit of \$5,000 from May to June was to improve the bank's position to help out his mother. But "purpose" is linked in statute to Bank's purpose and such would be hard to prove.

3. But can collect from mother since it resulted in an indirect preference to her

a. when \$10,000 claim of bank is taken care of by set off due to \$5,000 deposit, then \$5,000 more equity in jeep for mother.

G. T v. Doctor (garnishment on wages \$300)

1. T cannot avoid garnishment if the transfer is deemed to have occurred when the writ was issued as 2 cts. have held. Here writ was served March 15 outside 90 day period.

2. But good argument that each time wages are deducted, the transfer occurs at that time.

Debtor's rts. to_challenge rts. of his creditors

1. Ark. has limited exemptions which control. Since John is single he can claim \$200 in personal property, \$1,200 in a car - he cannot claim homestead since he is single (besides mtge can collect against homestead

and John even if married could only claim remainder).

2. Debtor can use his \$1,200 on his Chevy or Jeep. Since Jeep secures mom he will want to attack Chevy's lien on the Chevy.

a. Under 522 (f) D can avoid, to extent it impairs his exemption, as long as C holds non PMSI interest in certain property

b. although refinancing may have eliminated Chevy's PMSI status debtor cannot avoid because autos are not included within the list of property unless a tool of trade of the Debtor.

C. Depending on value of mom's claim John may use \$1,200 on Jeep.

3. John's \$200 on personal prop. could be used on his stereo

a. XYZ's claim is not a PMSI and stereo prob. comes within "household goods", therefore Sch. can avoid under 522(f).

Nondischarge ability 727

A. Here perhaps D knowingly made a false oath in connection with the case by leaving off statement some of his assets. In re Savel - defined "fraud" as signing documents with a calculated disregard of the document's importance.

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Outline Ques. 2

Discuss whether he can file both 109 and limits on Chapter 13 are \$100,000 unsec. & \$350,000 sec.

A. Property of estate - large personal injury award 541

1. clearly prop. of estate in 13 and must use all disposable income to pay off debts 1306 & 1325

a. In Ch. 7 a large part may be prop. of estate pro rata for work done before the petition cases dealing with taxes, but military pension' not allocated

2. But future income (not generated by work performed before the petition will not be part of estate in a) but will in a Ch. 13

3. His large income may in fact preclude his filing a Ch. 7 successfully 707 allows a judge to dismiss a Ch. 7 for abuse

B. Treatment of various debts & assets in Ch. 7 & 13

1. include general statement of liquidation vs. payment

2. \$20,000 malpractice judgment - lien on boat \$10,000 if levy soon but T will avoid judicial liens as pref. so boat will be asset to pay off unsecured and \$20,000 will be fully unsecured

a. In Ch. 13 it is unclear whether the judicial liens can be avoided. Ch. 13 does not give D avoidance powers, one ct. has said D can exercise 522(t)(1) - here prob. is showing impaired an exemption as unmarried D has \$200 exemption in personal property

3. IRS \$5,000 this is a nondischargeable seventh priority debt 507(a)(7) & 523 (a)(1)

a. even in a Ch. 13 it must be paid in full, all priority claims must be paid in full 1322(a)(2)

4. \$5,000 from firm - unsecured so C gets a prorata payout and then will be discharged

a. If discharged, firm cannot discriminate against the debtor 525. But hard to prove.

b. In Ch. 13 D may possibly treat differently it than other unsecured debts. 1325 allows classification of debts. But cannot discriminate and only codebtors are explicitly protected.

5. House mtg. - not given value of house and mtg. In Ch. 7 no exemption except for \$800 residential exemption mtge would be paid amt of claim plus interest if over secured. In Ark. (Fed. \$7,500 522 (d).)

a. In Ch. 13 may cure default within reas. time. 1322(b)(5) not (b)(2) since long term debt secured only by residence. Two circuits hold default can be cured even if even though once accelerated debt is no by undue accelerated. after the plan

1. But since curing the default D will have to pay T's fee which is based on % of amt. paid. (Fo-Oter)

6. 2nd Bank \$5,000 - transferred car

a. may be willful and wanton - conversion discuss 2 lines of opinion. If it is W & W, then not dischargeable 523 (a)(6)

b. In Ch. 13 can treat as unsecured and 7th Cir. has held nondischargeable debt is entitled to no more under "best interests" test than regular unsecured indebtedness.

C. 1328(a) provides that debt will be discharged if payments are made under the plan

7. Corvette & 280 Z \$20,000 debt and \$18,000 value in Ch. 7 the cars will be abandoned 724 and then 2nd bk. can replevy

a. D might be able to keep cars in Ch. 7 by continuing to pay on the debt, since he is not in default on the loan

1. cts. disagree on whether filing bank and discharge represent a default. If no default C cannot replevy.

2. If D has the money he can redeem by paying \$18,000 - consumer goods, abandoned.

3. Reaffirmation no longer need to show in best interest of debtor - but C must agree

b. Ch. 13 must pay 2nd value of cars plus interest

1. but Miller has held even if comply with

13 ct. will allow relief from stay if no equity (here) and not necessary for an effective reorganization 362(c)(2)

2. so may lose cars in ch. 13 also

C. Desire to open up business

a. in Ch. 13 must devote all disposable income to plan so money won't be available

1. but ch. 13 does not have 6 year bar to refiling and if business failed may want to refile

b. ch. 7 future income not property, estate but 6 year bar to refiling g D. General discussion of amounts paid to secured and un-secured in ch. 7 & 13.

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Outline Ques. 3

A. T v. 1st Bank

I. 30,000 payment to 1st bk. outside 90 day pref. period. But it constituted an indirect pref. to an insider.

a. corp. officers are insiders □ 101. Therefore pref. period expanded to one year.

a. T must prove XYZ was insolvent at the time of the payment

2. Cts. split on whether this insider pref. enlarges the 90 day period for the actual transferee (1st bk.)

3. But no pref. here to Bk. since it was fully secured. It had a 1st lien on \$80,000 worth of equip. and payment to a fully secured C does not make the C any better off than it would have been in a Ch. 7 payout.

4. Arguably there is no pref. to Pres. either due to fully secured status.

B. T v. Brown (Pres.) Purchase of 4,000 shares

1. Robinson Rule - since corporate remained unpaid ct held the transfer took place on the day of the petition, even though it actually seemed to take place in 1985 Fraud conveyance □ 548

a. the transfer did improve the position of the pres. by transforming his position as a S.H. to that of a creditor - not for reas. equiv. value

b. Model Corp. Act changes Robinson rule

C. T v. IRS - assume lien was filed □ 724 subordination

1 unavoidable tax liens are subordinated by □ 724

a. here 1st bk. takes \$20,000 then \$50,000 lien used to pay 1st - 5th priorities

b. priorities 1st (admin. claim \$10,000 post pet. wages) and maybe (but prob. not \$10,000 sales claim and possibly \$10,000 severance claim) 3rd priority, \$60,000 wages earned 90 days prior to petition or cessation of business

c. limited to \$2,000 per employee but 40 employees here

d. IRS takes if any part of \$50,000 is left but it is not.

e. 2nd Bk. then takes \$10,000

f. then IRS \$50,000

D. Payout

1. Admin expenses - \$10,000 wages (\$10,000 sales probably not-benefit was received by estate but not incurred by the estate □ 503)

a. Severance claims of \$10,000 given admin. priority only if for no notice. If instead it is for years of service, it is a 507 (a)(2) claim instead so 1st bk. \$20,000 of equip and \$10,000 admin and \$50,000 of \$60,000 wage claims paid from equip.

2. Payment of unsecured. Metropolitan \$20,000 legal services insurance. This is given 3d priority since employee benefit plan owed 180 days before petition.

a. But given priority only to the extent 4th priority \$2,000 is not used up. They use of \$60,000 or \$70,000 of \$80,000 claim so Met. gets 3d priority for \$10,000 or \$20,000

b. IRS gets 7th priority for \$50,000 claim

C. so nothing will remain for nonpriority unsecured claims \$25,000 and \$10,000 sales claim if not given admin expense

E. T v. ABC \$20,000 ck for shoe parts

1. Once 1st ck. bounced it became a credit trans so not contemporaneous exchange
2. maybe payment in ord. course of business - but must be for both C & D - problem "D's" here
3. Maybe saved by "subsequent" advance a rule 507(c)(4)
 - a. depends when transfer is deemed made when ck deposited or when ck. paid by drawee bank.

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Ques. 4 Outline

A. BCD executory K 365 assumption

1. Since K is in default 365 (b)(1) requires Flo to cure the default and give adq. assurance of future performance
2. BCD cannot refuse or block the assumption

B. 1st Bank admin. freeze

1. 1st Bk has set off rt. on \$20,000 but freeze of act may violate the stay since 362 stays the post petition set off. Cts. split
2. Flo cannot use cash collateral however without 1st getting court approval 363
 - a. to get approval Flo will have to make sure 1st is adequately protected - lien on new accounts for expm.

C. 2nd Bk. can be forced to turnover the equip. under 542

1. But 2nd bk. is entitled to be adequately protected
 2. discuss adeq. protection 361 and Am. Mariner
- D. LL cancellation of lease
1. LL cannot use bank clause to cancel lease
 2. 365 lease can be assumed
 - a. 365 (b)(1) default will have to be cured
- E. 363 credit discussion

F. can sell inventory 363 in the ord. course of business but proceeds are cash collateral and need ct. approval before debtor can use.

Professor Flaccus
Summer 1986
BANKRUPTCY
Final Exam

QUESTION I
(Approximately 1 Hour)

John Debtor, a Fayetteville, Arkansas resident, has been having financial trouble lately. These started when his wife divorced him January 1, 1985. John did not appear at the divorce hearing and his wife was awarded all of their property including unimproved land in Madison County which the parties had held as joint tenants. He filed a Chapter 7 bankruptcy on July 1, 1986. He had purchased a car from Chevy, Inc. in June 1985, which took and perfected a security interest in the car. On January 1, 1986 the parties refinanced the transaction giving John a longer time in which to pay the debt. On May 1, 1986 John got a loan from ABC finance in order to buy a TV and ABC filed its financing statement May 5. Since the TV had to be specially ordered John did not pick it up until June 1. On May 1, 1986 John also bought a boat from M & M Boats. M & M sold the boat on credit taking a security interest. M & M filed its financing statement May 15. John used his stereo system to secure a loan made by XYZ. Such loan was made May 15th and XYZ filed May 24th. The stereo system is also being claimed by John's dentist. The dentist got a judgment on May 1 and a writ of execution was levied on the stereo system May 20th. The dentist is owed \$500. The judgment interest rate is

5% and a state statute gives the dentist a claim for attorneys fees. After the divorce, John bought a house but he defaulted on his payments starting in December 1985. The mortgagee, 1st Bank, foreclosed and bought the house for \$30,000 at a foreclosure sale May 1, 1986. John had waived his right of redemption. First Bank has paid \$500 in 1986 taxes on the property. John's bank account is with 2nd Bank which has a perfected security interest in John's jeep. John's mother as a junior lien on the jeep for money she lent to John. Second Bank is owed \$10,000 and the jeep is worth \$7,000. John wages have been garnished by John's doctor who has a judgment for unpaid fees. With agreement from John the garnishment was served March 15 and was continuing at the time of bankruptcy.

At the time of the bankruptcy filing the Madison County property is owned by Bea Brown who bought it from John's former wife. John's bank account has \$10,000 in it, \$5,000 of which was deposited between May 1 and June 15, 1985. Second Bank claims a set off right. John's Chevy is worth \$3,000 and Chevy, Inc. is owed \$4,000 on the refinanced note. John's TV is worth \$1,000, the amount of the debt to ABC. John's boat is worth \$2,000 the amount owing to M & M. John's stereo is worth \$1,000, XYZ is owed \$800.00. John's house now in First's hands is worth \$60,000. The debt owed to John's doctor is \$1,000. Since March 25, \$300 has been garnished from John's wages. Under cross examination John admits he left off several assets from his bankruptcy schedules.

Discuss who has what rights in bankruptcy.

QUESTION II

(Approximately 1 Hour)

Bob Brown is an unmarried attorney in financial trouble. He has come to you indicating that he wishes to file bankruptcy. Advise him on whether he should file in Chapter 7 or 13 and why. Be sure to indicate how he would be treated in each. Bob's practice is exclusively plaintiff personal injury litigation. Currently he is working on a big case that will go to trial next month. He gets to keep 30% of the award. He wants to open up in the next year or two a men's clothing store. Two weeks ago a former client got a \$20,000 judgment against him for malpractice and John has no insurance. Two days later the sheriff levied on John's \$10,000 boat pursuant to this judgment. He owes the IRS \$5,000 for last year's income taxes. Bob is just an associate in his firm and he borrowed \$5,000 from the firm and had not yet paid it back. He is 3 months behind on his house mortgage payments and 1st Bank, the mortgagee, has accelerated the debt and is threatening to foreclose. Two weeks ago he sold a third car he owned to a friend and 2nd Bank, which had a security interest in the car, has declared a default on the loan as a result. Five thousand dollars is owed on this loan. The car was worth \$5,000. Bob has two remaining cars, a corvette and a Datsun 280Z. He would love to keep both cars. Second Bank has a security interest in each vehicle and is owed \$20,000 whereas each vehicle is worth \$9,000. The loan is not in default. Bob is a playboy and wants to keep his cars and his boat. He has no other assets other than the ones mentioned above and owes, in addition to the debts mentioned above, \$2,000 to various trades people in town. His income varies considerably but averages \$25,000 a year. The pending lawsuit could generate a \$30,000 fee.

QUESTION III

(Approximately 45 Minutes)

XYZ, Inc. located in Little Rock, Arkansas, filed a Chapter 7 bankruptcy petition July 1, 1986. It continued to operate as a business until August 1st. XYZ makes shoes. It owes \$20,000 to 1st Bank. Jerry Brown, XYZ's president, has guaranteed the debt. On January 1, 1986 it owed 1st Bank \$50,000 but a \$30,000 payment was made to the Bank at that time when the Bank threatened to accelerate the debt. Mr. Brown had once owned 5,000 shares of XYZ or 80% of the total. On January 1, 1985 XYZ bought back 4,100 of these shares and gave Mr. Brown a \$10,000 promissory note which remains unpaid. On February 1, the IRS slapped a lien for \$50,000 on XYZ's equipment which is worth \$80,000. First Bank has a prior security interest in the equipment and 2nd Bank is junior to the IRS since it perfected -after the IRS filed. First Bank is owed \$20,000 and 2nd Bank is owed \$10,000. The 40 employees had their work terminated July 26th. They claim \$60,000 in unpaid wages for the period April 1 to June 30 and \$10,000 for work from July 1 to July 26. They claim \$10,000 in severance benefits. Metropolitan claims \$20,000 in unpaid premiums XYZ was supposed to make in March, April, May and June, on the employees' prepaid legal services program. ABC, XYZ's major supplier of shoe parts claims \$20,000 for shoes it delivered May 12th. It had previously delivered \$20,000 worth of shoe parts May 1st. XYZ had paid for these \$20,000 worth of parts by check received May 5th which bounced. Since XYZ wished to keep ABC's

business it sent another check which arrived May 10th and was paid by the Bank May 15th. MNO, Inc. claims \$10,000 for sales work it did for XYZ during May and June. The orders from this sales work were made in July. In addition to the assets XYZ has above, it has \$30,000 in unsecured accounts receivable. It also has \$25,000 in unsecured trade debt. Who is entitled to what at the Chapter 7 pay out by the trustee.

QUESTION IV

(Approximately 15 Minutes)

Flo's, Inc. filed a Chapter 11 bankruptcy petition yesterday, July 1, 1986, and has come to you for advice. It wants to continue its business of selling women's clothing. BCD, Inc., its major supplier has refused to send the July shipment of clothing. Flo's has a contract with BCD for monthly deliveries through December. The contract calls for payment 60 days after delivery. BCD says it won't ship until Flo's pays the April bill it owes them. 1st Bank is owed \$20,000 by Flo and won't honor any of Flo's checks on Flo's checking account. There is \$20,000 in the account. Second Bank a week before repossessed Flo's equipment pursuant to its security interest. Flo's needs the equipment to continue to operate. Flo has \$20,000 in unsecured accounts receivable. It is one month behind on its rent. When the landlord learned of the bankruptcy filing it told Flo's that he was going to cancel the lease. Flo's wants to know what it can do to keep its business ongoing. What advice do you give Flo's?