

The Massachusetts School of Law

Bankruptcy, Fall 1993  
Kitaeff Final Exam

Please answer each of the following three essay questions in the accompanying blue-book. Each question has equal value.

1. In 1988, Sam and Joe Smith (brothers) formed a Massachusetts corporation called ABC, Inc. Since that time, the corporation has been operating a retail store called "STEREO, PLUS", in Wilmington, Mass. and the enterprise has been only marginally successful. The corporation presently employs the two principals, two administrative staff and six (full time and part-time) salespersons. For the past six months business has been especially difficult and Sam and Joe are facing the reality that they cannot continue to do business in the same manner, considering new competition that has adversely affected their profitability. In fact, for the last two weeks they have not been able to pay payroll and they are seriously behind in their payments to vendors. Most vendors have refused to ship except for cash, in advance.

The corporation owes BayBank, their primary lending source a total of \$145,000 which debt is secured by a lien on all of the corporation's assets which are worth approximately \$60,000 at cost. The corporation has not made its December loan payment to the Bank and the Bank has threatened to call the note fully due and payable. In addition, 9 retail customers have tendered deposits ranging from \$300 to \$1500 for specially ordered merchandise (each deposit is equal to 50% of the selling price) and none of the products are available to be delivered - the deposit monies have been used for general overhead. The corporation owes \$37,000 to its general unsecured creditors and the landlord has threatened legal action and eviction if the rent (now overdue for Nov and Dec, 1993) is not paid within 4 days.

Sam and Joe have just made a deal with a super-discounter to purchase brand-name but yearold merchandise at significant savings (off the cost price) and they feel that this could change their profitability for the future in a very positive manner. However, they don't know if the business can last that long.

Advise your clients as to the various alternatives available. They are concerned about the rights of various parties in any proceedings, but they know that they must do something quickly.

2. Bill and Sally (not married) own a house in Andover, Massachusetts that has a fair market value of \$150,000. Their mortgage to Andover Bank has a principal balance of \$150,000, but is three months in arrears (the monthly payment is \$1245 principal and interest). Bill and Sally pay their real estate taxes on their own and are currently two years in arrears, for a total real estate tax delinquency of \$4,000. The Internal Revenue Service and the Mass Department of Revenue are owed \$6,000 and \$1,800 respectively for 1990 income taxes based on returns that were filed on time. Between Bill and Sally, they owe their general unsecured creditors, for credit card and medical debt, approximately \$24,000. At your meeting with them

yesterday, Bill has admitted that in the last 60 days he took cash advances on his MasterCard totalling an additional \$3,000 and has reached the credit limit. He used the money to purchase the HI-fi system of his dreams, thinking that the boost to his emotional well-being would give him the ability to handle his financial affairs in a more productive manner.

Bill's car, a 1989 Chevrolet, is worth about \$6,000 and has no lien and is free and clear. Sally leases her 1991 Toyota and is current on the payments. Both Bill and Sally have defaulted on the final payment on their auto insurance and a notice has just been sent to the car leasing company that the insurance policy has already been cancelled; the car leasing company considers this a technical default in the lease contract. Yesterday, Bill had a minor auto accident, but the person whose car he hit is alleging injury.

Sally works as a nurse at a Municipal hospital and has accumulated \$32,000 in a municipal pension plan. Bill has \$25,000 (fully vested) in his employers ERISA qualified pension plan, and he has \$2,000 in an IRA that he started about a year ago. Bill and Sally's household goods and wearing apparel, etc., are normal and ordinary and nothing unusual in value.

Finally, Sally has disclosed to you that she had borrowed \$10,000 from her brother and over the last 3 - 8 months has repaid all but \$3,000 of the total.

Bill and Sally would like to keep their home and all of their assets and seek your advice. Analyze their situation and provide them with alternatives.

3. Mary is a single woman and a resident of Boston, Massachusetts. She purchased her condominium residence in 1978 and paid \$31,000 at the time. As the value of the condo rose over the course of time, she refinanced the unit at least three times and presently owes \$96,000 to Shawmut Bank secured by a first mortgage. Interestingly, her condo unit is in a beautiful building in Boston's Back Bay area and has a fair market value of about \$110,000. Because of recent difficulties in her employment situation (she was "laid off" in what she believes was a serious violation of the anti-discrimination laws - because she is of mixed ethnic background), she has had no income for a while and is 4 months in arrears on her mortgage and 6 months in arrears on her condo fees. The Bank is about to start foreclosure proceedings. Mary is about to go on her third interview for a job prospect and feels very positive about becoming employed almost immediately.

Over the years, Mary has amassed substantial personal property such as furniture and jewelry - all paid for and of significant value. During the real estate heydays of the 1980's, Mary purchased two investment condos. Each is now worth \$40,000 but each has a mortgage balance of \$75,000. The mortgages are current but the tenants intend to leave over the next 90 days. Two years ago she filed a tax return but did not pay all the tax called for and is now paying \$300 per month on the \$4,000 balance. She has become despondent and has recently "maxed out" her credit cards to maintain her lifestyle and she now owes about \$14,000 to MasterCard, American Express, etc. Mary's father, who is very ill, just himself inherited \$100,000 and intends to leave it all to Mary - he knows nothing about her situation. Advise Mary.

Advise your clients as to the various alternatives available and the effect each may have upon their lifestyle, their ability to reorganize their personal financial life and their ability to maintain their residence.



In 1989, Bob and Mary purchased 4 condominium units in the City of Lawrence, for investment purposes, and borrowed against the equity they had at the time in their home to come up with the down payments. Each of the 4 condo units is worth about \$20,000.00 but the mortgage balances are about \$30,000.00 each. Bob and Mary are two months in arrears on each of the four separate mortgage loans, which are with four separate banks. The management of the units has become a nightmare and Bob and Mary would be happy to get out of the condo and real estate business altogether. Each of the four banks is beginning to threaten to foreclose, if the mortgage is not brought up to date. The Smith's income does not permit them to do so and maintain their regular living expenses.

Bob owns a 1987 Chevrolet sedan free and clear, which is worth about \$2,000.00 - Mary is still paying \$427.50 per month on her 1990 Mercedes Benz 190. The car loan has a balance of \$19,000.00 and is current but the car has minor problems and some body damage and is worth about \$15,000.00. Bob prides himself as an amateur photographer and has accumulated camera equipment worth about \$4,000.00 and wants to keep it, almost as much as Mary wants to keep her car. Bob earns about \$5,000.00 per year in freelance photographic work, using this equipment. At your office conference, Bob just informed you (and Mary) that over the past three years, he has "borrowed" approximately \$15,000.00 from the cash box at the health club, to fund various expenses. He has been confronted by the owner of the club who is willing to defer any criminal action so long as Bob pays back all of the money, and the owner is willing to keep Bob employed at his regular salary. Bob is thankful and remorseful but is certain that as soon as he pays back all the money (at the rate of \$100.00 per week), he will be asked to leave the health club.

Bob and Mary seek your advice. They know a little about bankruptcy and have heard about Chapter 13. They would like to keep their home. How will you inform them about the various alternatives available so that they can make an informed decision about their future? What advice would you give and why?

2. Allied Enterprises, ("Allied") is a Massachusetts Corporation, which operates various retail stores in four (4) New England states, selling consumer goods, such as toys, electronics, jewelry and furniture. For years, Allied enjoyed a good reputation for value and service, but Allied is now having financial difficulty. Allied locations are generally in desirable suburban malls and retail centers. Most of Allied retail stores leases were entered into in the late 1980's and call for rental payments which are extremely high. However, three of the retail locations have leases which were entered in the mid-1970's and call for substantially below market rental rates, even in these difficult economic times. A number of retail operators have expressed interest in "purchasing" the balance of Allied's leases on those three locations, which leases terminate in 1999. Therefore, three of the locations have leases which represent significant value.

Since October, 1992, Allied has been faced with "new retail challenges" and is finding it impossible to pay its debts as they mature. The United Bank, which has a mortgage (security interest) on all of Allied assets (inventory, furniture, fixtures, machinery, equipment, etc.) has made a demand upon Allied to cure its payment arrears, which is currently quite substantial (three months arrears at approximately \$25,000.00 per month). In addition, at least six of Allied's largest trade creditors have threatened to institute suit because of overdue invoices. Besides the tough business climate, the reason for Allied's difficulty is that it has had to pay an out of Court settlement with the Massachusetts Attorney General's Office for alleged violations and has used almost all of its cash flow available to satisfy this obligation. The Attorney General has threatened criminal prosecution against the company and its principals if any payment is missed and to further complicate matters, Allied's employees are considering a discrimination suit and allege that Allied is also in violation the a National Labor Relations Act, for interfering with the employee's attempts to unionize.

John and Tom Allied, the principals of the corporation, consult you and inform you that they feel they may lose the various battles facing Allied and they feel that they need to consider liquidation. In their opinion, the assets of Allied (inventory, furniture, etc.) are worth approximately four million dollars "at liquidation", but would probably be worth six to seven million dollars if sold in the ordinary course of Allied's business operations. In addition, John and Tom feel that an appropriate liquidation would also create substantial value for the balance of the term of the leases which are "under market". The United Bank is presently owed approximately 1.9 million dollars and trade vendors are owed an additional 1.7 million dollars.

John and Tom further inform you that they themselves can probably find excellent top management positions with other companies or in other areas, but feel that they need to do "the right thing". As a result of your probing questions, John and Tom also inform you that the corporation presently owes approximately \$250,000.00 in back vacation pay, \$100,000.00 in federal corporate taxes and they have been asked to now personally guarantee the bank loan balance, which Tom and John absolutely refuse to do. They are not willing to subject their "modest" personal wealth to the claims of any party as a result of the operation of the business, although they do remember that they did personally guarantee one trade vendor, whose balance is presently \$37,500.00.

Tom and John feel that the only way Allied can survive the present economic turmoil would be for a cash infusion of approximately one million dollars. Though they have these monies personally, they are unwilling to make the further investment or loan to the corporation and feel that since they are nearing retirement age, they would rather close the business, pay all the corporate obligations and consult for others.

Over the last six years, the corporation has paid both Tom and John approximately \$400,000.00 per year and those salaries have continued at that level, despite falling sales and increased expenses over the last three years. Finally, the men inform that they have not reported all sales from certain consignments, the consignors are threatening legal action (including the possibility of criminal prosecution) and Tom and John now seek your advice.

They would like you to inform them regarding all of the aspects of Chapter 7 Liquidation for this Corporation. You must also advise them with respect to the procedure, substantive law and the likely result of a Chapter 7. They are good listeners, but need to know how each of the facts they have presented impact on a liquidation and any potential personal responsibilities they may have. They are also very interested in the matter in which funds will be distributed as a result of a Bankruptcy liquidation, including how the various consumer deposit creditors (who put deposits on consumer goods, which were never delivered) will be treated.

3. Andy and Susan are in the process of a not so amicable divorce. Andy and Susan were married in 1985, when both graduated college. Andy was born and raised in Boston and started his married life with little money, but great hopes for the future. Susan, on the other hand, comes from a wealthy family and has received payments from a substantial trust fund ever since she was eighteen. Both Andy and Susan are now thirty years old.

For the last four years, Andy has worked for a small computer software company, which has done quite well and his income has increased from \$25,000.00 (to start) to the \$65,000.00 that he is presently earning. His prospects are quite good. Susan has worked part time during the marriage and has had no lack of material things, because of the substantial trust fund income that she has enjoyed. Because of Susan's income, the couple have enjoyed a lifestyle which was significantly greater than Andy's income would otherwise provide. Andy will miss this lifestyle, but feels that he can do just fine on his income, alone.

In 1988, at the height of the real estate market, Andy and Susan bought a penthouse condominium in Boston's fashionable Beacon Hill neighborhood. They paid \$450,000.00 for the two bedroom duplex and borrowed \$300,000.00 from a local bank. Susan paid the balance of the purchase price from part of her annual trust income. Today, the condominium is worth \$290,000.00 and the mortgage balance has been paid down to \$275,000.00. However, the mortgage interest rate is still 10% and the payments are substantially more than Andy can afford on his own. The couple separated approximately four months ago and Andy has not been able to make any payments on the mortgage since that time. The bank has been calling Andy and has already begun foreclosure proceedings against Andy and Susan. During

their brief marriage, both Andy and Susan became spendthrifts, of a sort and incurred substantial consumer credit card debt, to the extent of \$35,000.00 on a joint basis. They are both responsible for the credit card obligations. Andy is seeking your advice about the possibility of a bankruptcy of some other form other of reorganization and it is clear that you cannot represent both Andy and Susan, since their interests and goals obviously conflict.

Andy informs you that his divorce attorney is attempting to get a substantial cash settlement from Susan, considering her substantial annual trust fund income, but Andy informs you that the Trustee of Susan's trust has the right to determine, in the Trustee's discretion, how much is to be paid to Susan on a regular basis. The Trustee has threatened to hold further disbursements to Susan until she "gets her life in order" and, until then, will only pay for the necessities. Andy still feels that he can get a reasonable property settlement from Susan, but would like to consider a bankruptcy before that happens, so that he can keep the money he gets from Susan after he has received a discharge in bankruptcy with respect to his debts. Andy also informs you that his wealthy Uncle Harry has just taken a turn for the worse and is not expected to live more than six months. Andy feels that Uncle Harry has always intended to take care of his favorite nephew (Andy) and Andy feels that his prospective inheritance, along with a nice negotiated property settlement from Susan will give him a great opportunity to start life fresh, to say the least.

Without moralizing, discuss with Andy the various legal issues presented and inform Andy regarding his various alternatives. In the last moments of your initial conference, Andy also adds that he has moved out of the Beacon Hill condominium into a small apartment with a new girlfriend and has rented the condominium to a notorious drug dealer who is conducting business directly from the duplex penthouse. You are hardly aware of the forfeiture laws of the United States as relates to drug dealing and real estate and Andy now adds that he is receiving a 10% commission on all of his tenants' drug deals, in addition to the monthly rent, which Andy is pocketing. Andy is not paying the mortgage, would like to forestall any foreclosure as long as possible, so that he can maximize on the commissions and intends not to tell anyone about the cash that he is "socking away". Andy feels that, compared to his soon to be ex-wife Susan, he has been dealt a difficult hand in life and feels that he has every right to protect himself financially.

MASSACHUSETTS SCHOOL OF LAW  
ANDOVER, MASSACHUSETTS

BANKRUPTCY LAW  
SPRING 1990

May 21, 1990

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Instructions:

For each of the following 20 multiple choice questions, choose the best answer by circle either a, b, c or d. Mark your choice clearly.

1. A Chapter 7 debtor can claim exemptions available
  - a. under Section 522(d) of the Bankruptcy Code
  - b. pursuant to any non-code exemption statutes
  - c. either (a) or (b) on an elective basis
  - d. from any exemptions available
  
2. A Chapter 7 Interim Trustee in Bankruptcy is
  - a. initially selected by the office of the U.S. Trustee
  - b. can be elected by unsecured creditors at a 341 (first meeting of creditors) meeting.
  - c. both (a) and (b)
  - d. chosen by Counsel for the debtor
  
3. Pursuant to Section 365 of the Code
  - a. an executory contract, if not assumed within 60 days, will be deemed rejected
  - b. an executory contract must be "cured" of default, if sought to be assumed.
  - c. a Chapter 11 debtor has essentially the same rights as a Trustee
  - d. all of the above
  
4. The filing of a Voluntary Petition in Bankruptcy
  - a. imposes an automatic stay with no further pleading necessary
  - b. requires a motion, to be relieved of an automatic stay, under Section 362
  - c. permits the continuation of action against a debtor only if such action has already been started
  - d. both (a) and (b)

5. A debtor's or Trustee's intended sale of property
  - a. must be noticed out to all parties in interest, unless specifically ordered by the Court
  - b. requires no notice to creditors, but due diligence and good faith by the seller
  - c. will only be allowed to proceed if the appraised value exceeds the secured debt (if any) by at least 25%
  - d. will not be permitted to proceed unless approval is obtained from a majority of unsecured creditors in both number and amount
  
6. A Chapter 13 debtor in Massachusetts
  - a. may file a Plan when it accompanies the initial Petition
  - b. may file a Plan within 15 days of filing the Petition
  - c. must file a Plan along with the Petition
  - d. either (a) or (b)
  
7. A Chapter 11 debtor's Plan and Disclosure Statement
  - a. must be filed within 120 days of the date of the Petition
  - b. must first be approved by the Court prior to notice to creditors and the solicitation of votes
  - c. may classify and categorize creditors into various classes and treat creditors differently
  - d. both (b) and (c)
  
8. A Chapter 7 debtor may
  - a. claim for his benefit all exemptions available under the statutory system elected
  - b. accumulate unclaimed exemptions in any property whatsoever, to maximize the exempt ability of of selected assets
  - c. select both Code or non-code exemptions on an asset by asset basis
  - d. exempt a personal residence to the extent of any equity, so long as minor children reside in that residence

9. A "preference", under the Bankruptcy Code sought to be recovered by a Chapter 11 debtor or a Trustee
  - a. can generally be recovered, if it can be shown if the payment was made within 90 days of the Petition date, on account of antecedent debt
  - b. cannot be recovered if the payment was made for simultaneous consideration given by the creditor
  - c. includes payments made to "insiders", however, the period is extended to 1 year prior to filing
  - d. all of the above
  
10. In order to have his or her Chapter 13 Plan confirmed, debtor must show
  - a. that the Plan is in the best interests of creditors, is the debtor's best effort and is feasible
  - b. that the Plan calls for payment over the term of the Plan that would pay unsecured creditors something materially better (in percentage terms) than would result if the debtor's estate were liquidated under Chapter 7
  - c. that he (she) has a reasonably stable source of income from which to make payments to the Chapter 13 Trustee
  - d. all of the above
  
11. If a Chapter 13 debtor with a "confirmed" Plan cannot make payments to the Chapter 13 Trustee
  1. the debtor may amend the Plan with Court and creditor approval
  2. the Trustee may file a Motion to Dismiss the case
  3. the debtor may convert to a Chapter 7 proceeding
  4. the Trustee may convert the case to a Chapter 7 proceeding
    - a. 1, 2 & 4
    - b. 2, 3 & 4
    - c. 1, 3 & 4
    - d. 1, 2 & 3
  
12. An executory contract rejected under Section 365 of the Code,
  - a. gives rise to a claim for damages against the estate by the party whose contract was rejected.
  - b. must be rejected within 60 days of filing of the Petition
  - c. requires notice an opportunity for hearing prior to effective rejection
  - d. will create an entirely separate class of creditor whose claim must be paid in full

13. A secured creditor whose value in the collateral is less than the amount of his claim
  - a. will nonetheless be considered fully secured
  - b. may have the amount of the secured claim reduced to that value, and the balance deemed unsecured
  - c. can vote the full dollar amount of his claim regardless of what portion may be secured by collateral value, in a Chapter 11
  - d. will always have a priority claim to the extent of the under-secured balance
  
14. An unsecured creditor in a Chapter 7 liquidation case will not participate in distribution of funds unless
  - a. the creditor has been owed monies or has an allowed claim for at least 90 days prior to the filing of the Petition
  - b. the creditor has filed a Proof of Claim with appropriate documentations supporting it
  - c. the debtor has scheduled the creditor's claim as undisputed and non-contingent
  - d. the Court finds that non-payment of the claim would create irreparable injury to the holder of the claim
  
15. The office of the U. S. Trustee
  - a. appoints an Interim Trustee for the purpose of Chapter 7 case administration and liquidation
  - b. prosecutes non-dischargeability complaints on behalf of creditors
  - c. approves or objects to unsecured claims of creditors
  - d. values real estate for the purpose of determining secured status
  
16. A non-dischargeability complaint for fraud, misrepresentation, defalcation, etc.
  1. may be maintained by any creditor with respect to that creditor's particular claim
  2. may be maintained by a Trustee, as to all debt, if the Trustee can show fraudulent intent of the debtor
  3. compels the debtor to maintain the burden of proof as to the non-existence of facts material to the allegation
  4. may be maintained by any party in interest up to 5 years after the filing of the Petition
    - a. 1, 2 & 4
    - b. 2, 3 & 4
    - c. 1 & 2
    - d. 1 & 3

17. A debtor can prevail in a complaint to avoid a judicial lien
  - a. to the extent that the judicial lien impairs the debtor's exemption claim
  - b. to the extent that the lien is preferential
  - c. to the extent that the judicial lien adversely affects the debtor's ability to get a fresh start
  - d. both (a) and (b)
  
18. The automatic stay imposed by Section 362 of the Bankruptcy Code will
  - a. stop a foreclosure proceeding
  - b. prevent a creditor in possession of assets of the estate from disposing of same, in collection of debt
  - c. give a Chapter 11 debtor at least some critically needed time and "breathing space"
  - d. all of the above
  
19. A Chapter 11 debtor cannot
  - a. conduct its business without advance approval of the office of the U.S. Trustee
  - b. obtain post-petition credit
  - c. dispose of assets except in the ordinary course of the debtor's business
  - d. seek to assume an executory contract
  
20. The distribution of proceeds in a Chapter 7 case will be made in accordance with the Code
  - a. to all secured creditors first, regardless of collateral liquidation value, then to all other parties pro rata
  - b. to all creditors who file Proofs of Claim regardless of priority
  - c. in payment of secured, exemption and administrative claims and other claims in descending order of priority
  - d. to debtor in recognition of exemptions first, then to all creditors, secured or unsecured, administrative or otherwise, regardless of priority, on a pro rata basis

Essay Question No. 1

Main Street Pet Shoppe, Inc. ("Main Street") is a Massachusetts corporation doing business in Andover, MA and Boston, MA.

Two years ago, in 1988, Main Street borrowed \$100,000.00 from Bay Bank to purchase additional inventory, pay some of its trade debt and install a sophisticated computer system from "Miracle Joe, the Computer King". Miracle Joe arranged a lease of the system for both stores and arranged for a financing of the lease with XYZ Leasing Company. XYZ purchased the system and leased it to Main Street with lease terms calling for 36 equal payments of \$3,000.00 per month and a purchase option at the end of the term for \$1.00.

The principal officers of Main Street, Mr. Jones and Mr. Smith seek your advise. They tell you that their cash flow is awful, they cannot afford the computer system (which is not performing according to plans and specifications anyway) and they have accepted deposits from 27 consumers for various animals that will cost Main Street approximately \$250.00 more per animal than originally contemplated. In your research, you find that Bay Bank only recorded a U.C.C. Financing Statement with the Town Clerk in Andover and failed to record any U.C.C. Financing Statement with either the Secretary of State or the City Clerk for the City of Boston. This alleged security interest in all assets, in favor of Bay Bank, is therefore subject to attack, as to validity. Your clients now tell you that the landlord in Andover has alleged a default for non-payment with respect to their lease, the lease terms call for \$3.00 per square foot to be paid monthly in advance and the lease has approximately 5 years to go. The lease is greatly under market value and your clients also inform you that 80% of their business is accomplished in the Boston store.

Finally, the Commonwealth of Massachusetts has just levied the corporate bank account for failure to pay sales taxes in the sum of \$25,000.00

Mr. Jones and Mrs. Smith have personally guaranteed the note in favor of Bay Bank, which now has a balance in the sum of \$82,500.00 and the Bank has threatened to consider the note in default for non-payment.

Your clients would like to stay in business and keep the Boston store operating; they feel that there is a market for the balance of the term of the lease in Andover and they would like to renegotiate, if possible, the note to Bay Bank. Additionally, the computer system is of no real value and the Boston store can be operated with a cash register and a simple ledger system for all bookkeeping etc.

Advise your clients as to the various alternatives available, your recommendations as to course of action and the results of the various recommendations you may give them. Be sure to discuss the effect any particular action may have on third parties (creditors or others).

Essay Question No. 2

Mr. and Mrs. Wilson have asked you to analyze their financial situation and make recommendations to them. They come to your office and state "We need to file Bankruptcy". During the interview with your clients, you find the following:

Your clients own a duplex home in Peabody, Massachusetts, with a present fair market value of \$225,000.00. The home is subject to a first mortgage in favor of ABC Bank, with a principal balance of \$145,000.00, however, they have not made mortgage payments for 5 months, in the monthly amount of \$1600.00 and are therefore substantially in arrears. The Bank has begun foreclosure proceedings and the sale is scheduled for June 7, 1990. Mr. Wilson informs you that he is presently employed as the manager of a small machine shop, in which he has no ownership interest, and it is rumored that the machine shop may be having financial difficulty itself. Mrs. Wilson provides day care in her home (the duplex in Peabody) even though she understands that there is a continuing risk for violation of the local zoning ordinance (no business use of any kind is permitted). Mr. and Mrs. Wilsons' combined income for 1989 was approximately \$50,000.00. They have 2 small children living at home, both under 10 years old.

Over the past 2 years, the Wilsons have enjoyed the use of their credit cards and have borrowed money from various banks and they presently have a combined unsecured debt obligation, to various creditors, in an amount of approximately \$25,000.00. One credit card creditor has instituted a suit against Mr. Wilson and has attached the family residence 76 days ago. A judgment has not yet been obtained in that particular collection action.

Mr. and Mrs. Wilson have resigned themselves to the fact that they might not be able to keep their duplex home. However, they would like your advise on how to protect the equity in the house for their personal benefit, if possible. In addition, they indicate to you that they are about to lease the other apartment in the duplex for \$700.00 per month, however, they are reluctant to do so if they are about to loose the house. The prospective tenant is a personal friend and they have disclosed nothing to him.

The Wilsons, in addition, have a tax liability to the I.R.S. and the Massachusetts Department of Revenue for 1988 and 1989 in the combined sum of approximately \$18,000.00. They have just received a notice of intent to levy and they advise that their bank accounts have approximately \$2,000.00 total on deposit.

Finally, Mr. Wilson advises you that he was in a car accident 2 years ago and that a suit is pending against the other driver and Mr. Wilson expects to receive settlement in the next few months that could amount to approximately \$30,000.00, net to him. The Bank has been informed but has decided not to wait and intends to proceed against the house.

MASSACHUSETTS SCHOOL OF LAW  
BANKRUPTCY

SPRING 1990-1991

SS# \_\_\_\_\_

ESSAY QUESTIONS

- I. In 1987, John Smith and Mary Jones, who were very friendly and long time tennis partners, decided to purchase a home in Andover, Massachusetts. The real estate market was at its peak and they purchased a lovely colonial home on a one acre lot for \$425,000.00. John Smith had his own business (with his partner, Sammy Sleaze) and came up with \$50,000.00 towards the down payment. \$25,000.00 came from John's own personal checking account and the other \$25,000.00 (unknown to his partner) came from the partnership checking account. Mary Jones put in \$10,000.00 from her own savings account towards the down payment and borrowed \$40,000.00 from her mother to make up her \$50,000.00 share of the total \$100,000.00 cash down payment. John and Mary then borrowed \$325,000.00 from the ABC Mortgage Company to close their purchase.

John and Mary, whose friendship is still solid but somewhat strained, come to see you in May 1991. They inform you that the bank that holds the first mortgage on their colonial home has elected to accelerate the mortgage debt and it appears that John and Mary are presently six months in arrears with respect to their mortgage payments of \$1,852.00 per month. They further inform you that they have no real intention of keeping the house, however, the house is no longer quite so "lovely", and it is now worth only about \$290,000.00, at best.

John's business appears to be in serious financial difficulty and the partnership presently owes approximately \$75,000.00 in vendor debt and John and his partner have seriously considered terminating the business. Mary, who most recently was working for a local bank, has been laid off and is otherwise unemployed. Just before she was laid off, Mary suffered a work related injury and is about to receive disability and worker's compensation benefits. She does not know exactly what they may amount to, in terms of dollars.

While John was watching his business (with his partner) flounder, he decided to "protect" the one thing he was most proud of: his thoroughbred horse named "Samantha". He informs you that about six months ago, he "sold" Samantha to his second cousin once removed, for the sum of \$500.00. In actuality, even though papers were passed between the seller and buyer (relating to the horse transaction) the second cousin once removed is actually "holding" the horse for John and the horse is really worth approximately \$25,000.00 on the open market. As a result of repeated questioning by you, Mary admits that she has approximately \$60,000.00 of accumulated pension and retirement funds which accumulated some years ago when she was working as a coach for the tennis association. Mary is forty-four years old. Mary's mother wants her money back.

Neither John nor Mary have any objection to the filing of a bankruptcy petition and seek your advice as to whether or not a reorganization or a "straight" bankruptcy would be in their best interest. Discuss the issues presented and advise John and Mary as to their choices so that they can make an informed decision.

II. Amalgamated Products Corp. ("APC") is a Massachusetts Corporation whose share holders are "Happy Harry", "Sad Sam" and "Mediocre Mike". Each owns 33 1/3% of the outstanding stock of this closely held corporation. Harry is the president and treasurer, Sam is the clerk and Mike spends most of his time at Bobby's Bar N'Grill offering investment advice to any one who cares to listen. The corporation is in the business of manufacturing display systems for various types of businesses and these systems are used at trade shows throughout the country. The corporation has both a sales and administrative staff; the sales people are paid on commission only and the administrative staff is paid (barely) either fixed weekly salaries or wages.

About two years ago, Happy Harry was approached by the company's hottest sales person who was about to close one of their largest deals. However, the \$300,000.00 sale would require the company agreeing to be paid over a twelve month period. Needless to say, the entire display system was manufactured and shipped and \$295,000.00 is still being carried on the books as an account receivable due from the customer. 10% of the sale (\$30,000.00) is due to the sales person as a commission. Only \$500.00 of this has been paid, however, the principals of the company acknowledge that commissions are due upon acceptance by the company of the sale.

Since this one sale represented a possibility of getting into the "big leagues", Harry, Sam and Mike went to their

local bank and arranged for the corporation to borrow \$300,000.00 for working capital. They personally signed this loan, as guarantors. Unfortunately, it turns out that Happy Harry was actually "Happy" for a particular reason: he supported his alcohol and drug habit by "borrowing" funds from the corporation, as needed. Over the past year, Harry "borrowed" over \$100,000.00. As a result, the Internal Revenue Service and the Massachusetts Department of Revenue are presently owed approximately \$71,000.00 (total) and both taxing authorities have contacted Harry and Sam as to the possibility of payment and the potential for a 100% penalty assessment.

Harry, Sam and Mike come to your office and seek your advice. Harry has beaten his alcohol and drug problem but is now in the middle of a bitter divorce. Sad Sam could not be any sadder, and Mediocre Mike wishes he never got involved in this company. They also mention to you that the corporation owes approximately \$125,000.00 in regular vendor debt and their relationship with their vendors is excellent. They have informed you that if they could get some "breathing" space and not have to deal with their present problems, they could turn the business around very quickly and keep all of their current bills up to date. Further, they feel that the company could be very profitable in about six months and they could have smiles if they could restructure the corporation's debts.

How would you discuss their situation and what advice would you give Harry, Sam and Mike. Remember, the bank took a lien on all corporate collateral (the lien is perfectly valid) and the bank perceives the value of all that collateral to be significantly less than what the corporation owes.