Bankruptcy

Fall 2012 Final Exam

INSTRUCTIONS

IN YOUR RESPONSE, PLEASE CREATE A HEADER WITH YOUR EXAM NUMBER SO THAT IT APPEARS ON EACH PAGE. DO NOT USE YOUR NAME ON YOUR RESPONSE.

SAVE YOUR ANSWER AS A WORD DOCUMENT USING THE FOLLOWING FORMAT FOR THE FILE NAME (SUBSTITUTING YOUR EXAM NUMBER FOR THE ****):

**** BANKRUPTCY ANSWER

UPLOAD THE ANSWER TO TWEN

This is a three hour timed examination. Your exam will be time stamped. I will allow you an additional 10 minutes to download and upload the exam. If for any reason your exam does not upload, immediately send it as an attachment to my assistant April Brooks at april.brooks@uky.edu Send a copy to yourself as well.

This is an open book examination. You may use any materials you wish. Although this examination is open book, statutory and case citations are not required and you are urged not to spend much time reviewing such materials. The better answers will include a thorough analysis of the issues presented rather than a string of citations.

Conciseness and clarity of expression, organization and clarity of presentation, while not separately taken into account in the grade, necessarily have some impact on the grader's evaluation of your understanding of the subject matter.

This examination consists of 4 pages and 8 questions. Each question is assigned a time limit that corresponds to the points available for that question. ALL ANSWERS MUST BE EXPLAINED. Your grade will be based on your analysis of the issues rather than your ability to come to a single "correct" solution.
1. (20 minutes) Don Debtor, an antique car collector and restorer, filed a Chapter 7 petition on September 1, 2012. About a week before the petition was filed, he purchased an old car from an estate sale for $1,500. The car was rusted and was not drivable but Don was convinced that he obtained a great deal. Cars of this vintage and in this condition usually sell for around $5,000. Over the following three months, Don has worked to restore the car in the garage attached to his house. Don has a considerable number of tools that he uses in his restorations. In addition, Don used supplies in the garage and, with earnings from his job as a mechanic, he purchased spare parts. All told, Don has about $5,000 invested in the car apart from his labor and the initial purchase price. Don recently received an offer on the car for $30,000. The trustee in Don’s bankruptcy now insists that he turn the car over to the estate. Can Don keep the car? If not, does Don have any rights to any of the proceeds the trustee is able to obtain from selling the car?

2. (20 minutes) Dora Debtor, Don’s wife, filed a joint Chapter 7 petition with Don on September 1, 2012. Her car is 2010 Cadillac. She owes $23,000 on the car. The relevant valuation guides provide several values for the car. The retail value is $25,000 and the trade-in value is $20,000. The guides also list a “private party” value (the value an individual seller might receive from an individual buyer) of $22,000. The loan is payable over 4 years and bears a 7% interest rate. The bank claims post-bankruptcy attorney’s fees of $1,500. Dora wants to keep the car. What will she have to do to accomplish that?

3. (20 minutes) Don and Dora jointly owe $30,000 on their single credit card, a Second Bank Visa. Over the past three months they increased the balances on the card by purchasing groceries at Upscale Markets, a high end organic grocery boutique (generally charging at least double the price charged at Kroger). The total grocery purchases amounted to $4,000. Other charges included gasoline ($600), restaurants ($1,500), a vacation at an all-inclusive resort ($5,000), greens fees at various golf courses ($800). At the time the charges were incurred, Dora was a partner at a large law firm but immediately before Don and Dora filed, Dora was hit personally with a substantial malpractice judgment ($2.5 million) and lost her job. Do the credit card charges present any problems for Don and Dora?

4. (15 minutes) The Second Bank Card Agreement from Question 3 provides that the debtor’s must pay collection costs and does not provide for a security interest in any items purchased with the card. Second Bank’s interest charges during the case are $800. Second Bank has incurred attorney’s fees in connection with the case in the amount of $3,000. What is the total amount of Second Bank’s claim?

5. (20 minutes) Consider the facts of Questions 1-4. Assume that Dora was a partner in a law firm until right before bankruptcy and was making well above $150,000 per year. Assume as well that Don and Dora do not have any children or other dependants and are in good health. How is it possible that Don and Dora are eligible for Chapter 7?
6. (30 minutes) Quick Mart, Inc., a company that operates small convenience stores around Lexington, filed a Chapter 11 bankruptcy petition on January 15, 2012. Since filing, the company has been working to streamline its operations and to close poor performing locations.

One such location is a convenience store located in a mixed residential/retail development near the University. The development has 150 apartment units and 6 retail locations that are primarily designed to meet the needs of the young professionals and students who live in the apartments. Tenants in the space include a bank, a bookstore, 2 restaurants, a coffee shop and the Quick Mart. Quick Mart owes Lexington Properties $5,000 in pre-petition rent. Unpaid rent accruing post-petition amounts to $2,000.

Although Quick Mart plans to close the UK location, it enjoys a favorable rental rate on its 10 year lease with the owner of the complex, Lexington Properties. The lease contains a clause that permits assignment only upon the consent of Lexington Properties and states that any assignment requires the payment of the Lexington Properties’ legal and investigative fees incurred in determining the suitability of the assignee.

Quick Mart has found a potential assignee. Bob’s Newsstand, Inc. is willing to pay Quick Mart $10,000 for an assignment of the five years remaining on the lease. Bob’s Newsstand sells soft drinks, magazines, candy, and other sundries but does not sell general groceries, beer or many of the other items usually sold in convenience stores. In addition to the sundry items Bob’s Newsstand sells, the store will contain a back room in which “head shop” type items (paraphernalia for drug use, incense and the like) and a selection of pornography will be sold.

You represent the Lexington Properties. The lease agreement contains a provision that reads, “The Lessee shall operate a convenience store on the premises. No other use of the premises is permitted.” Ideally Lexington Properties would like to terminate the lease and disapprove of the assignment. You estimate that your investigation of Bob’s Newsstand and representation of Lexington Properties will cost about $8,000. Lexington Properties would like to know whether they can stop this assignment. Advise them.

7. (15 minutes) If Lexington Properties is successful in stopping the assignment and Quick Mart decides to reject the lease, how will be Lexington Properties’ claim in the Quick Mart bankruptcy case be calculated?

8. (40 minutes) XYZ Holding Company (“XYZ”) has two subsidiaries, Software Development Corp. (“Development”) and Software Sales Corp. (“Sales”) As the names imply, before its bankruptcy, Development created computer applications which it sold to Sales, the distributor of the applications. Development has filed a Chapter 11 petition but Sales and XYZ have not.

Over the years Development borrowed substantial money from the unsecured bond and short term credit markets. At the time of bankruptcy, Development had outstanding debts of $20,000,000. For assets, Development had only computers, all of which were subject to security
interests securing claims in excess of their value, leased space in an office park at a market rental rate, and $10,000,000 in accounts receivable all owed by Sales.

Sales’ financial picture is considerably brighter. It owns an office in a glitzy downtown high rise, has $5,000,000 in cash, artwork, and marketable securities, and has $20,000,000 in accounts receivable owed by purchasers of software from Sales. All Sales owes is the $10,000,000 accounts payable owed to Development. Tammy Tycoon, the CEO of all three entities enjoys a lavish lifestyle funded primarily by dividends received from Sales and from a substantial salary paid by Sales.

The imbalance in assets and liabilities between Sales and Development started about 2 years before the petition date. Sensing that Development was having difficulty keeping up with trends in mobile computing, Tammy decided to make one last ditch effort at making the company work. She embarked on an expansion of the Development effort directed at creating upgrades for the company’s software, which was fast becoming obsolete. At the same time, she slashed the price that Sales paid Development for those upgrades. Development’s debt increased from $5,000,000 to $20,000,000, over the course of 6 months. Unfortunately for Development, the amount Sales paid for the software upgrades failed to keep pace. Since Sales was doing well in its sales of the upgrades to end users, Tammy was not terribly concerned. But the low price paid by Sales and high debt levels ultimately caused the Development’s bondholders to declare a default and that default resulted in Development’s bankruptcy.

You represent the unsecured creditors’ committee in Development’s bankruptcy case. You are confident that the estate can collect the $10,000,000 owed on the accounts and anticipate that once that is done, the debtor will file a plan abandoning the remaining assets. Nearly all of Development’s employees have quit and the company is not currently operating. What strategies do you have to increase the creditors’ recoveries?