

Morris
Creditor's Rights
Spring 1983

QUESTION I (40 Points)

Dunn, the owner of a small business in Columbus, Ohio, is deeply insolvent. She suggested a composition agreement to her largest creditor, Carr, Carr told Dunn that he would accept a composition only if Dunn paid 60 percent of the current \$25,000 debt owed. Dunn responded that she would be quite willing to pay Carr 60 percent of the debt, but that she could not pay her other creditors an equal amount and continue in business. She further noted that her only reason for suggesting the composition was that by reducing her debt and getting a discharge from creditors, she could continue to operate her business. She told Carr that under his terms, she could only pay her other three business creditors, Ames, Bates, and Engle, 40 percent. Nonetheless Carr remained adamant in his demand for 60 percent (\$15,000). Sometime later Dunn offered Carr a first mortgage on Black Acre, real estate worth \$5,000, as partial security for the \$25,000 debt. The mortgage plus a \$10,000 payment would satisfy Carr's demand. Carr accepted this arrangement. The mortgage was properly recorded on January 10. Thereafter Dunn, with Carr's assistance, organized a composition agreement in which creditors Ames and Bates, to whom Dunn owed \$10,000 each, and Carr, agreed to accept a payment of 40 percent of their claims by June 1 from Dunn in full satisfaction of their claims. The same offer was made to Engle, to whom Dunn owed \$15,000, but Engle demanded 75 percent payment and refused to sign the composition agreement. The composition agreement, which is identical to the form set out in pages 359-360 of the casebook except for the terms noted above, was signed by Ames, Bates, Carr and Dunn on April 1. On May 28, Dunn paid Ames, Bates and Carr the amount specified in the composition agreement, and each of these three creditors gave Dunn a release of the rest of her debts to them. On June 21, Engle

discovered all of the facts set out above. In addition he learned that Ames knew of the transfer to Carr but Bates did not. He has come to you to find out what he can do to recover his money. Engle is a trade creditor of Dunn; none of his debt is secured. Despite the composition, Dunn's business is not prospering. Dunn has been in default for two months and has told Engle that she cannot pay anything at the moment. In addition to Engle, Dunn has ten other creditors, five of whom are employees to whom she owes around \$1,000 each. Engle also discovered that on April 5 Dunn had a savings account at Rich Bank worth \$10,000. Dunn lives in an apartment and has only moderate furnishings. She does, however, own a 1982 Mercedes 450 SL worth approximately \$18,000. Prestige Auto Loans has a perfected security interest in the car to secure a debt of \$16,500.

Indicate the alternatives open to Engle if any, and the course you would recommend to your client.

QUESTION II. (40 Points)

Hamilton Burger is a May 1982 graduate of the What's A'Matter U. School of Law. While his classmates considered him to be carefree, he was actually very concerned. Ham had been involved in an automobile accident in 1975, and the party injured in the crash, Perry Mason, had obtained a judgment against Ham for \$26,300. Mason had docketed the judgment on January 28, 1977, in Montgomery County,

Ohio, where Ham resided at the time the judgment was rendered. On January 29, 1982, Ham threw a party for a select group of law students who had read Sec. 2329.07 of the Ohio Code ([copy attached](#)). Ham blitzed through his final semester and passed the bar examination in July. He also began work at his brother Warren's law firm. When the good news that he had passed the bar exam came in October, Ham had a new sign posted in front of the firm's offices located in Dayton, Ohio. The new sign read: Cheeze, Burger, Cheeze, Burger and Chips. (Warren's partners were Troilus and Cressida Cheeze, formerly of Athens, Greece, and Fishen Chips, the famous admiralty lawyer)

Ham quickly became the firm's franchise law expert, and he was making big bucks in the space of six months. Ham decided to make some of his money work for him, so he purchased some unimproved land in Montgomery County, Ohio, for a total purchase price of \$11,000 which he paid in full at the closing on May 1, 1983. The rest of Ham's money had gone to various haberdashers for custom-made suits that Ham felt compelled to wear. Thus, his only assets were his clothes and the unimproved lot. On the other side of the ledger, Ham owed \$70,900 to his stockbroker when some securities he bought on credit became worthless, \$16,800 in federally guaranteed student loans which he had begun to repay in November, 1982, at a rate of \$115/month, and the \$26,300 judgment to Mason. In addition, Ham owed approximately \$1500 on each of four separate credit card accounts.

Just as things seemed to be going so well for Ham, he learned that Mason had instituted an action against him in Montgomery County under Sec. 2325.15 of the Ohio Code ([copy attached](#)). The action was filed on June 9, 1983. This circumstance not only knocked Ham out of the fast lane, but it caused him to reconsider his future. Ham decided to leave the law practice behind and become a short order cook at one of the fast-food restaurants that he had set up five months

earlier. He hoped to work his way up to night manager. Nevertheless, this new job did not pay too well and Ham could not even pay his current, modest living expenses, never mind make any payments on his educational loans or the credit card bills. Fearing that something financially drastic had occurred, the three credit card companies filed an involuntary Chapter 7 petition against Ham on September 3, 1983. Ham, having sworn off the practice of law, did not answer the petition, and the court entered an order for relief against Ham on September 24, 1983.

Assume that Ham sees the light and hires you to represent him in the case. What actions would you take on his behalf?

As trustee, what actions, what actions would you take to "collect and reduce to money property of the estate?" (Bankruptcy Code Sec. 704(1))

Assuming administrative expenses in the bankruptcy proceeding of \$1,700, and due and unpaid real estate taxes on the vacant lot of \$900 (these taxes are given lien status under state law from the day they are assessed), how would you distribute any funds that come into your possession?

QUESTION III. (40 Points)

Luke and Kate McCoy owned a small farm as tenants in common in Idaho. Idaho has not opted out of the

federal exemption scheme. The fair market value of the farm is \$260,000, and it is mortgaged to the Federal Land Bank to which \$215,000 is owed. Luke also owns approximately \$105,000 worth of farm equipment which is subject to a perfected security interest in favor of the Southwest Production Credit Association ("PCA"). Luke owes PCA \$130,000, Luke also owes \$22,000 to County Feed and Grain on an open account basis, and \$23,000 to a total of five other trade creditors. Finally, Luke owes two farm hands \$900 each for their last three weeks of work.

Luke and Kate grow potatoes on the farm. These crops are harvested annually in September, and, apart from an occasional odd job around town, Kate and Luke have no other income. They used to own 50 acres of land worth \$25,000; however, they transferred it to their 14 year-old son, Little Luke, who had recently been awarded a third place ribbon in the regional 4-H agricultural fair. They gave Little Luke the deed to the property on December 25, 1980 when their net worth was nearly \$75,000, Little Luke recorded the deed in the Spud County Clerk's office on February 19, 1983.

The trade creditors, including County Feed and Grain, are becoming aggressive and litigious. Three of them have filed suit against Luke and have stated that they intend to collect every last dime! Luke's legal expenses are climbing and his lawyer has called for advice concerning Luke's legal alternatives. Outline the full range of Luke's realistic alternatives. If an alternative is not available, state your reasons for concluding that fact. Of course, you need not consider the possibility of Chapter 11 relief.

END OF EXAMINATION