Morris
Creditor's Rights
Fall 1994

QUESTION 1. (10 Points)

Terry Davis owned three video rental stores. Each store was located within one-half mile of a shopping mall, and each store had been successful in the past. Increased competition from nationwide chains (Blockbuster, etc.) as well as local libraries and other retail outlets had put a strain on Davis' business. In fact, Davis intended to streamline the business by closing one location and focusing attention on the other two stores.

On March 16, 1994, Davis began to advertise the sale of the real estate at the Mega Mall location. She would consolidate the inventory of that store at the Giant Mall video rental location and the Big Mall location. Notwithstanding the excellent location near the Mega Mall, offers to purchase the property were few and far between. Finally, in late July, 1994, Bob Lloyd, a real estate investor, inquired about the property. Davis' asking price was $175,000. This would have generated $90,000 over the $85,000 mortgage balance owed on that property. Since Davis had not received any offers on the property for several months, however, she was not in a very strong bargaining position when Lloyd inquired about the property. In fact, Lloyd was aware that the heightened competition in the video rental industry had taken its toll on Davis and that she was in a particularly vulnerable position with respect to the property she was selling. During the negotiations over the purchase price for the property, Davis indicated to Lloyd that she would be willing to offer a deep discount on the purchase price if Lloyd would pay cash for the property. It seemed that Davis had to make a $25,000 payment to her primary video supply by August 1 or face being cut off from her current supply of videos. Of course, that would have seriously impaired her ability to operate at the other two locations. As a result, Davis agreed to sell the property to Lloyd for $125,000. She had made it clear to Lloyd that she was unhappy with the deal, but that she felt that she had no choice but to make the sale to keep her other businesses going. Lloyd's only comment in response to Davis' statement to that effect was that Lloyd "Couldn't care less about the other two locations." He said, "I am in this to make money, not friends."

Lloyd did just that. Four months after he purchased the property, he sold it to a national restaurant chain for $195,000. This was also a cash deal, and reflected the fair market value of the property at the time.

The restaurant chain, Unbeatable Beets, Inc., spent another $40,000 remodeling the building and adapting it to its "All Beets All the Time" restaurant style. The new restaurant has done a booming business ever since, and has flourished on the heels of a report from the Harvard Medical School that beets reduce cholesterol in the blood stream.

Davis has not fared so well. The money she received from the sale of the Mega Mall location only stemmed the otherwise rising tide of debt for a short time. The other two locations have become more and more unprofitable, and on December 14, 1994, Davis filed a Chapter 7 bankruptcy petition. Not only had she been losing money due to decreased video rentals at her stores, but patrons of the store have brought suits against Davis due to injuries they suffered when a scuffle broke out between two store employees over the benefits of colorization of classic films. The patrons were hit by flying "colorized" versions of "It's A Wonderful Life." These claims along with mounting business debts led to the filing of the bankruptcy petition.

First Bank had a valid and properly perfected mortgage on all of the remaining real estate owned by Davis. In addition, First Bank had a properly perfected and otherwise valid first security interest in all of the personal property of the business. Furthermore, First Bank's claim was undersecured. Thus, as trustee you have abandoned all of that property back to First Bank. You are concerned about the sale of the Mega Mall location, however, and by your investigation you have verified that the property is now owned by Unbeatable Beets, Inc.

What action, if any, would you take as trustee to recover additional property for the benefit of the bankruptcy estate. What responses/defenses would you expect the defendant(s) to raise? What result would you anticipate? Be sure to support your conclusions with appropriate analysis and reference to the applicable law.

QUESTION 2. (50 Points)

Norm and Vera live in a modest home with their two children, Jack who is eleven and Jill who is six. They purchased the home in July of 1989 for $87,500 by paying $4,400 down and financing the remainder with American Mortgage Corp. The mortgage was for thirty years with interest accruing at 9.5% on the unpaid balance. The monthly payment on the mortgage was $700, with an additional $150 per month to fund the escrow for taxes and insurance on the property.

About two years ago, Norm was laid off from his job at Interstate Motor Sales, the automobile dealer where Norm had worked as an automatic transmission technician. The auto dealer went out of business, and it took Norm fourteen months to get another job in his field of expertise. He has been working for the last year or so at Carl's World of Cars (CWC) as a transmission specialist. Unfortunately, while Norm was unemployed his daughter, Jill, suffered a bad fall in the backyard of their home and was hospitalized for over two weeks. The uninsured medical bills totaled $35,000.

Norm and Vera initially thought that Norm would be out of work for a short time, so they did not immediately "tighten their belts" when he was first laid off. They lived off of their savings of $6,000 for the first three months of his unemployment period, and they supplemented the savings by using their credit cards to make a number of purchases as well. When the savings ran out, they used the credit cards even more and paid a small amount on each card as the bills came in. They were able to borrow some money from their parents, and Norm did odd jobs and picked up some part time work as well. Nevertheless, this was insufficient to make ends meet. They accumulated some significant debt until he went to work at CWC. Throughout this period, Vera had remained at home with the children.

After Norm went back to work, they tried to begin to catch up on the past due bills. They paid an "extra" amount each month on the credit cards to begin to reduce those balances, and they tried to be particularly careful about their current expenditures. In September of 1993, Norm and Vera took out a $12,500 "consolidation" loan that they used to pay some bills and to pay to the first mortgage lender for the back payments that they owed.

The first mortgage was brought current, and the consolidation loan lender took a second mortgage on the house. They still owed some bills, but Norm and Vera believed that the worst was behind them. They had not counted on the creditor seeking to collect the medical claim being very aggressive. Instead, they thought that they could pay that claim off slowly until Vera took a job outside of the home once the kids got just a little older. Much to their dismay, however, the medical debt holder obtained a judgment against Norm and Vera which the creditor properly filed such that it became a lien on the house as of July 14, 1994. The creditor also began to garnish Norm's wages. This was particularly difficult for Norm and Vera because they were again strapped for cash and could not pay the second mortgage in October, November, and December. They also could not pay the first mortgage on December 1, 1994, when it was due.

It is now December 19, 1994, and they have come to you for your assistance. Norm and Vera's assets and liabilities are set out below. Also provided is the current budget Norm and Vera have prepared. Their only knowledge of bankruptcy comes from the Yellow Pages where they have seen advertisements by lawyers. They want to know what their options are and what course of action you would propose for them.

ASSETS

House	$77,000
Norm's Car	9,500
Vera's Car	2,500
Furniture	1,200
Clothing	500
TOTAL	$90,700

LIABILITIES

American Mortgage Corp.	$80,000	(1st mtg.)
Consolidation Loans Inc.	12,000	(2nd mtg.)
Chrysler Credit Corp.	11,000	(lien on Norm's car)
Visa	15,000	
Mastercard	11,000	
Jack Peterson (Norm's Dad)	4,000	
Linda Taft (Vera's Mom)	6,000	
Medical Collectors	35,000	(judgment lien)
IRS (1991 income taxes)	2,500	
TOTAL LIABILITIES	$176,500	

INCOME -- Norm's monthly take home pay is $2,800

EXPENSES

American Mortgage Corp.	$850	(first mtg.)
Consolidation Loans Inc.	150	(second mtg.)
Utilities (incl. telephone)	200	
Chrysler Credit Corp.	250	(Norm's car loan)
Food	450	
Transportation	100	
Insurance (life & disability)	100	
Clothing	100	
Cable TV	25	

Recreation	100
Miscellaneous	75
Tithe to Church	100
TOTAL	$2,500

Given their budget, assets, and liabilities, set out the options available for Norm and Vera, and what option you would suggest best fits their needs. You should assume that the state exemptions available in the jurisdiction mirror those of Sec. 522(d) of the Bankruptcy Code. Indicate whether you would anticipate any challenges either by the trustee or creditors. Be sure to support your conclusions with appropriate analysis of the pertinent issues.

QUESTION 3. (10 Points)

Alpex Computer Corp. was like a lot of smaller companies in the computer business. It was heavy on ideas, but short on cash. In 1977, it obtained a patent on "bit mapping" which allows computerized images from a video game to be electronically reproduced for maneuvering on a television screen. The patent was so valuable, that it permitted the extraordinary growth in the video game industry over the last fifteen years. Unfortunately, Alpex has not been around to see it.

In the early 1980/s, sales increased dramatically in the video game market, primarily to the benefit of

Nintendo, Inc. Alpex complained to Nintendo that it was violating the patent Alpex had obtained in the 1970's, however, Nintendo continued to market its products and asserted that its system was sufficiently different from the process patented by Alpex such that Nintendo was not violating the patent rights. Alpex eventually succumbed to the business pressures, leaving behind substantial debt and very little in the way of assets. The total value of the "hard assets" available at the time that Alpex closed its business in 1983 was $100,000. However, included among the assets scheduled in the bankruptcy filing by Alpex was a claim against Nintendo for patent infringement. The value of the claim was listed as unknown, but Alpex had filed a complaint in the proper federal district court and sought damages of $100,000,000.00 plus interest. After just four months in a Chapter 11 proceeding, the Alpex bankruptcy case was converted to Chapter 7. The Chapter 11 petition was filed on April 6, 1983 and the case was converted to Chapter 7 on August 22, 1983.

The bankruptcy case has remained open pending the resolution of the Alpex/Nintendo litigation. Last week, the federal district court awarded Alpex $100.4 million in damages for the patent infringement. The interest on that amount raised the total judgment to $125 million.

You have been appointed trustee of the Chapter 7 estate. The prebankruptcy assets and liabilities of the debtor are set out below. In addition, the bankruptcy court had approved the employment of the attorneys representing the estate in the patent infringement litigation pursuant to a contingent fee contract that would award 40% of the recovery in the action to those attorneys. The bankruptcy court also approved a fee to the trustee in the case of $1,000,000. Alpex had a large number of other creditors, but many of them are grouped together below for purposes of simplicity. For example, Alpex owed a significant amount to a total of over 250 trade creditors, All of those trade debts are amounts due to the creditors on open account. Similarly, for the last two months of operations, Alpex had only ten employees. Each of the employees earned $8,000 per month, however, none of them received any wages for the final two months of the company's operations. The category described as "bank debt" is a large loan made by a consortium of banks to Alpex in the mid 1970's. The consortium consisted of ten banks each of which contributed eight million dollars into the fund which was loaned to Alpex.

As trustee, you have reviewed the books and records of Alpex to determine whether any other assets exist that might be available for liquidation and distribution to creditors. In conducting your investigation, you reviewed the checking account records of Alpex for 1980 to 1983. The only noteworthy transactions involved payments that Alpex had made to Consolidated Power Co. Throughout 1980 and 1981, Alpex had paid $35,000 per month to Consolidated Power. Alpex was on a "level billing" system with Consolidated during that period. In 1982, however, Alpex made $35,000 payments to Consolidated only in January and February. Thereafter, the payments became irregular and sporadic. A table describing the account with Consolidated Power from March 1, 1982 to April 1, 1992 follows:

Date	Debt	Payment	Balance
3/1/82	35,000	O	35,000
4/1/82	35,000	O	70,000
5/1/82	35,000	O	105,000
5/9/82		90,000	15,000
6/1/82	35,000	O	50,000

7/1/82	35,000	O	85,000
7/6/82		50,000	35,000
8/1/82	35,000	25,000	45,000
9/1/82	35,000	O	80,000
10/1/82	35,000	O	105,000
10/4/82		85,000	20,000
11/1/82	35,000	O	55,000
12/1/82	35,000	O	90,000
12/22/82		45,000	45,000
1/1/83	35,000	O	80,000
2/1/83	35,000	O	115,000
2/7/83		35,000	80,000
3/1/83	35,000	O	115,000
3/22/83		20,000	95,000
4/1/83	35,000	O	130,000

As trustee, indicate whether you would take any action against Consolidated in connection with this case. You may assume that no statute of limitations is applicable to the matter. In addition, indicate what response you would expect, if any, from Consolidated in regard to your action. Finally, set out the distribution of the assets that you anticipate having available for distribution to creditors in this Chapter 7 proceeding.

Be sure to support your conclusions with appropriate analysis in reference to the applicable provisions to the Bankruptcy Code.

ASSETS		LIABILITIES	
Equipment	$ 100,000	Bank Debt	$80,000,000
Nintendo Suit	125,000,000	Trade Debt	7,000,000
TOTAL ASSETS	$125,100,000	Employees	160,000
		Consolidated Pwr	130,000
		TOTAL DEBTS	$87,250,000

QUESTION 4. (20 Points)

The Bankruptcy Reform Act of 1994 became effective on October 22, 1994. It includes a number of amendments to the Bankruptcy Code, and the legislative history accompanying the enactment varies as to the extent to which each provision is described. Section 221 of the Amendments establishes another category of nondischargeable debts under Sec. 523(a). The entire commentary on the provision states that "This section makes loans that are used to pay federal taxes nondischargeable under Sec. 523. This will facilitate individuals' ability to use their credit cards to pay their federal taxes."

Please comment on Sec. 221 of the '94 Amendments. State whether you believe that this is a positive, negative or neutral (or some combination of these) change to the Bankruptcy Code. Indicate why you have come to that conclusion by offering an example or examples of the operation of that section.

END OF EXAMINATION