BANKRUPTCY LAW

Mr. Czarnetzky Exam No. _____
Final Examination
Fall 2003

INSTRUCTIONS

1. Put your EXAM NUMBER where indicated on the upper right hand corner of this page. DO NOT put your name, ID number, or any other form of identification anywhere on your examination.

2. When you finish the exam, hand your exam paper in at the front of the room. You are not permitted to make copies of this examination or of your answers.

3. Make your answers complete, but to the point. Answer only in the space allotted for each question. Write in NORMAL SIZED handwriting. Extra-small, micro-printing will NOT be appreciated, and will make the grader peevish. Anything written outside of the space provided will not be read and will not be taken into account in grading your exam. Organize your answers well.

4. Please note that your submission of answers to this examination constitutes assent to the following pledge which you should read well and appreciate:

HONOR PLEDGE

BY THE ACT OF SUBMITTING MY EXAMINATION PAPER AND/OR BLUE BOOKS FOR EVALUATION, I DO PLEDGE ON MY HONOR THAT I HAVE NEITHER GIVEN NOR RECEIVED ANY IMPROPER ASSISTANCE AND THAT I WILL REPORT ANY IMPROPER ASSISTANCE GIVEN OR RECEIVED BY OTHERS OF WHICH I BECOME AWARE.

6. This is an **OPEN BOOK** exam. You may use any materials which you bring with you to the exam. However, you may not use materials in the library or electronic databases. Furthermore, any collaboration of any sort, with any individual, is a violation of the above Honor Pledge to which I will respond by failing the parties involved.

7. You have **3 hours** to complete this examination. Each question has its point value noted. I wish you all the best of luck in the future.

QUESTION I
(12 points)

Mr. and Mrs. Karolya have just proposed a standard three-year plan in their chapter 13 bankruptcy case. They are a retired couple who receive, after taxes, $2,500 total income from a combination of social security and pension plan savings. Their chapter 13 plan proposes to pay a total of $480 per month to fund payments to their unsecured creditors. They have no secured debt. The Karolyas have $18,000 in nonexempt assets.

The Karolyas' plan calls for the following monthly payments: $800 for rent, $200 for health and life insurance, $200 for groceries, $100 for social clubs, magazines, and other subscriptions, $50 for their grandson's tuition college, $ 450 to their church as a charitable contribution, $100 for health aids, and $100 general spending money for entertainment and incidentals. These amounts are the same or approximately the same as the Karolyas have spent before the chapter 13 filing.

You represent one of the Karolyas' unsecured creditors, Caring Hospital. Are there grounds for objecting to the Karolyas' plan? What are they?

QUESTION II
(15 points)

You are the debtor's lawyer in the chapter 7 bankruptcy of Jerry Mayers who teaches antitrust law and copyright at the University of the Southern States Law School in Biloxi, Mississippi.

Six months before filing his bankruptcy case, Mayers incurred several debts which led to the following claims in his bankruptcy case.

First, Local Bank filed an unsecured claim for $950. Six months before his bankruptcy filing, Mayers had applied for a loan for $1,000 to pay for his various bad habits. Local Bank had him fill out a financial statement in connection with the loan. He had nine debts totaling $12,000. He asked the loan officer what to do, and the bank official told him to "just do your best." Mayers listed the four highest debts totaling $8,000, but omitted the other eight. Mayers signed the financial statement and gave it to the bank official, who promptly put it in the filing cabinet. The bank officer then immediately gave Mayers the $1,000 in $50 dollar bills.

Second, a claim for $7,555 by American Express for charges on Mayers's American Express Charge Card. Mayers tells you that for the two years before bankruptcy, he let his sister use the card because she was starting a business and needed the credit. Further discussions reveal that Mayers's sister has been receiving government assistance for five years, and that her business is already in financial difficulty because she cannot pay its bills. Mayers says he shouldn't be responsible for this bill, but you determine that his sister is not an authorized card holder under Mayers's account agreement with AMEX.

Finally, Mayers's brother loaned him $2,000 a month before his bankruptcy filing with "no questions asked." Apparently Mayers had done the same for his brother awhile back, and his brother wished to reciprocate. Mayers promptly went to a local casino and blew all of the money. While losing at blackjack (he plays based upon "his gut, not his brain"), Mayers told the dealer that his brother and his whole family "could go to Hades for all I care – they've taken from me all my life, now I'm going to get them."

Anticipate any arguments that the foregoing creditors might make in seeking to maximize their recovery in Mayers's bankruptcy case, and evaluate what the result will be. Please state any additional facts that might be relevant to a final determination in each case.

QUESTION III
(16 points)

Edward and his brother, Daniel, each own 50% of the stock in Politoski Sausage Company, Inc. ("PSC"), and, along with their sister Helen, the only members of PSC's Board of Directors. Edward was having a spot of financial trouble, so on January 15th, 2003, he was pleased when PSC's Board of Directors voted each stockholder a $20,000 dividend. (Assume this was all proper under the appropriate state corporation law).

Unfortunately, Edward's financial troubles continued and, indeed, worsened. According to the minutes of PSC's Board of Directors meeting on July 31st, 2003, the directors decided that the dividend that had been paid in January was a mistake. At that meeting, the shareholders/directors Edward and Daniel, signed loan papers promising to repay the $20,000 to PSC. On August 1, 2003, Edward repaid the $20,000 to the company. On December 1, 2003, Edward filed a petition for relief under chapter 7 of the Bankruptcy Code. On the schedules attached to his bankruptcy petition, Edward listed no secured debts, no nonexempt assets, and unsecured debts of $50,000, mostly to casinos near his home. As of today, Daniel has not repaid any part of the $20,000 to PSC.

Do the above facts give rise to any cause or causes of action in Edward's chapter 7 bankruptcy case? If so, who may bring the case or cases, and why? Analyze the possibility of success of any such case or cases, and take into account any potential defense or defenses.

QUESTION IV

(6 points)

Among the proposals for reforming chapter 7 of the Bankruptcy Code which Congress has entertained over the past several years are the following:

(A) Deny access to chapter 7 to anybody whose household income is above $50,000 per year, unless such an individual can prove severe hardship.

(B) Require debt counseling for every individual debtor.

Do you support these two proposals? Why or why not?

QUESTION V
(6 points)

Richlake was in a bar brawl two years ago, and was successfully sued by Mayers, the guy that he hit. Mayers's judgment was for $200,000. Moreover, Richlake owes the federal government $40,000 in income taxes for the past year's taxes, and $45,000 in past alimony and child support to his ex-wife. Finally, Richlake owes $25,000 in a bar bill which he says he does not recall, but which is reflected in the following signed statement on a bar napkin: "I owe Bar $25,000, /s/ Richlake." These are his only four creditors. If Richlake files a chapter 13 case, what arguments will be presented against his discharge?

QUESTION VI
(9 points)

Until a month ago, Vaaler was a penurious law professor at the Yalobusha County School of Law, an unaccredited law school here in Mississippi. As part of a new legal research business he has started on the side, Vaaler borrowed $50,000 from the federal Small Business Startup Administration, a branch of the U.S. government. Vaaler and the SBSA became embroiled in a dispute which started approximately eight months ago. There were suits and countersuits. The SBSA claimed that Vaaler had defaulted on the loan, whereas Vaaler claimed that one of their loan officers had forgiven the loan on behalf of the agency under a special program promoting the interests of bachelor Norwegian private investigators.

About six months ago Vaaler's crazy Aunt Lorelei died leaving him $200,000 in cash. Vaaler promptly purchased a house on the beach in Destin, Florida,[1] to which he moved two months ago after fixing it up. The house cost $190,000, and Vaaler spent $10,000 fixing it up.

Last month, Vaaler approached the federal Small Fisherman's Loan Agency, a federal agency charged with making loans to fishermen, particularly those that are new to the business. The SFLA denied Vaaler's request for a $50,000 loan because, as the loan officer told him, "your history with Uncle Sam is not all that stellar now, is it, Mr. Vaaler?"

Vaaler filed a chapter 7 bankruptcy petition last week in the U.S. Bankruptcy Court for the Western District of Florida, and he hired you as his personal attorney. He lists no assets other than his Florida house. What, if any, concerns do the above circumstances raise in your mind on behalf of your client? Why, and what result(s)?

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[1] Remember that Florida has an unlimited homestead exemption which applies in bankruptcy cases in that state.

QUESTION VII
(11 points)

You represent Local Finance Co. ("Local"). Local lent $30,000 to Casimir secured by a 1995 Peterbilt truck. On October 1, Casimir filed a chapter 13 bankruptcy case. The loan balance is now $27,500 broken down as follows: $23,000 in principal; $3,000 in interest up to October 1; $1,000 in interest since October 1; and $500 in collection expenses from before October 1. You estimate that it will take another $500 in attorney's fees to represent Local in Casimir's bankruptcy.

Local gathers the following information for you. A brand new Peterbilt, the same model as Casimir's, sells for $50,000. There have been ads in the newspaper for 1995 Peterbilts like Casimir's for $29,000 and $26,000. You know a truck liquidator who says he can sell the truck in one day at an auction sale for $22,000.

What do you advise Local about its rights in Casimir' bankruptcy?

QUESTION VIII
(16 points)

Biohazard, Inc. ("BI") is a Cleveland, Ohio company specializing in the manufacture of battery acid for use in automobile batteries. For years, BI has dumped industrial chemical waste in a "waste pond" behind their plant which is located next to their headquarters building in Cleveland. BI continued to dump waste into the pond until yesterday because there is no other way to dispose of this waste, which is the byproduct of BI's innovative method of manufacturing battery acid.

BI owes Cleveland Bank $5,000,000 secured by the property on which BI has its headquarters building and its manufacturing plant. The property was appraised, as of last week, at $4,500,000, and declining in value every day because of the waste dumping.

Yesterday, the Environmental Protection Agency ("EPA"), a federal agency with the power to take actions necessary to protect and clean up the environment, obtained an injunction against BI. The injunction called for BI to cease and desist from dumping industrial waste into the waste pond and to clean up the pond and restore the land to the condition it was in before BI owned the property. BI estimates that the cleanup could cost $5,000,000. Other than its real property mentioned above, BI has approximately $1,000,000 in cash, and no other assets of any value. BI has unsecured creditors who are owed $3,000,000 in total.

After receiving the injunction, BI filed a petition for relief under chapter 11 of the Bankruptcy Code. Anticipate what motion or motions one or more parties might file immediately in BI's chapter 11 case, evaluate the arguments that parties may make at the hearing or hearings on those motion(s), and predict the result(s).

QUESTION IX
(15 points)

TRUE OR FALSE AND WHY?

1. If a debtor is able to propose and fulfill a chapter 13 plan that meets all relevant legal requirements, chapter 13 is more favorable to a debtor than chapter 7.

2. In a chapter 7 case, as long as the debtor signs an agreement with an unsecured creditor after the filing of the debtor's bankruptcy case, the debt to the unsecured creditor must be paid despite the bankruptcy discharge.

3. As a result of the bankruptcy code, unsecured creditors are, practically speaking, subsidized by undersecured creditors in a bankruptcy case.

4. The only limitation on a creditor's ability to file an involuntary case against a debtor is that the proper number of creditors, as defined by the bankruptcy code, join the involuntary petition.

5. In a plan under chapter 12 of the Bankruptcy Code, a farmer must pay the holder of the mortgage on his farm pursuant to the terms of the mortgage without any modification.

6. Under the Bankruptcy Code, statutory liens are avoidable by the bankruptcy trustee.

7. Czarnetzky is your favorite Polish-American bankruptcy professor at the University of Mississippi School of Law.