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SYMPOSIUM HYPOTHETICAL: HEAVY DUTY

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INTRODUCTION TO HYPOTHETICAL

What follows is the “MASTER” hypothetical that will govern this conference—both the bankruptcy and the corporate segments. The hypothetical contains basic factual information that should, as a general matter, work for all the geographical regions that are represented. However, there are clearly historical, legal, cultural, sociological and economic factors that are unique to each region. These factors and their impact can best be addressed by the representatives of these regions. However, to alert readers to areas prone to differences, we have supplied some endnote questions. Selected material is also in brackets to designate possible regional differences.

MASTER HYPOTHETICAL

Heavy Duty Equipment Manufacture (“Heavy Duty”) is a business that produces [farm and construction equipment.]¹ It is the largest operating manufacturer and the largest employer in the City of Hope. Hope is located on a major river; it has a population of 100,000 people.

Heavy Duty has been in business for forty-five [five] years.² Today, it is a family owned and controlled enterprise.³ The patriarch of the family is 75 years old and is the [Chief Executive Officer.]⁴ The patriarch's son, age 45, is the Chief Operating Officer, and the patriarch's daughter, age 40, is the Chief Financial Officer. The patriarch's niece and nephew (ages 30 and 35, respectively) work in the manufacturing operations. The

1. In some regions, industries other than farm and construction equipment are more suitable. Consider what kinds of manufacturing enterprises best fit the hypothetical for each region. The hypothetical seeks to identify a business that is extremely useful and important to the region and produces something that could be exported.

2. In some regions, businesses of this duration do not exist. Accordingly, each region should consider a time-frame that suggests the greatest continuity possible. Stated differently, we are not addressing a completely new, start-up business. Further, it is possible that the forty-five year period reflects the aggregate of both public and private ownership, with government ownership occupying the greatest segment of time.

3. How has Heavy Duty been structured in the years since its formation? What effect does this have, if any, on its current situation?

4. The exact titles of corporate officers/management differ from region to region. (Additional references also appear in the next two sentences.) The appropriate nomenclature should be employed by the representatives from each region.

family makes all decisions involving Heavy Duty. Over the years since the business' formation,⁵ the family has contributed [five million dollars] (\$5,000,000)⁶ to the business, which includes a recent infusion of one million dollars (\$1,000,000).

Heavy Duty employs [one hundred (100) managerial personnel and five thousand (5,000)] factory workers.⁷ It has 2,000 retirees and provides some form of pension and health benefits for these former employees.⁸ Heavy Duty has a relatively small office building and a large physical plant. The plant is housed in a decaying building, and the manufacturing machinery is predominantly old but functional. The land underlying the office is owned by the patriarch and his family.⁹ The land underlying the manufacturing facility and the adjacent dock facilities have been leased from the City of Hope under a 99 year [9 year] written lease.¹⁰ The lease provides, among other things, that: (1) financial failure (including insolvency, bankruptcy or receivership) terminates the lease; and (2) transfer, assignment and sublease are prohibited.

Heavy Duty's business is cyclical. The products it manufactures have an average useful life of ten years. Its most significant product line is [heavy earth movers, particularly bulldozers.] Its annual gross income from all products is twenty million dollars (\$20,000,000) and its annual earnings for 1994, after taking into account all costs,¹¹ were one million

5. The contributions have been made since the business went private, even if that time period is short.

6. The size of the business in question may not work well for all regions. For some, it may be too large; for others, it may be too small. If necessary, the hypothetical can be altered by deleting or adding a "0" from/to the numbers in the hypothetical and the balance sheet.

7. In some regions, this number of workers is far too great as businesses are not that large. Again, these numbers can be adjusted.

8. What is the likelihood that such benefits exist? Assuming they do exist, what is the typical nature and extent of such benefits?

9. The ownership of land is problematic in select regions. Consider whether the land once was privately held and then taken over by the government. Reappropriation of the land from the government to private owners may be a possibility. For purposes of the hypothetical, the possibility of split ownership (private/public) is considered although that may not be a realistic dichotomy in some regions.

10. In some regions, a 99 year lease is not permitted or feasible. If a 9 year lease works more satisfactorily, that should be employed. However, in all events, the idea is to create as long a term of lease as is possible. It should also be noted that in some regions, a lease of any sort is not an option; in these regions, all land utilized in a business is owned not leased.

11. What kind of costs are applicable? Taxes? Wages? Pension contributions?

dollars (\$1,000,000). The business began to fail in early 1995 and by the end of the calendar year, it owed its creditors ten million dollars (\$10,000,000). The losses were caused by a variety of factors, most particularly a shortage in raw materials.¹² The business owed suppliers (collectively owed \$3,000,000 and numbering over 50), its bank lenders (which are secured) (owed collectively \$5,000,000), its current employees (for one week's salary per employee) and retirees for a pension contribution (collectively \$250,000), taxing authorities (\$1,000,000) and its owners (\$250,000). Heavy Duty also has encountered a recent problem. Apparently, its manufacturing plant has been polluting the adjacent river, and polluted water is travelling downstream to local communities that rely on clear water for farming and home use. (See attached balance sheet).

Insurance? Overhead? Local or regional regulation?

12. The cause of the shortage could differ significantly from region to region. Consider what might cause the shortages in the regions in question. For example, is the problem's cause exogenous or endogenous to the region? What is the effect, if any, of the currency markets?

BANKRUPTCY QUESTIONS

Heavy Duty needs relief from its financial problems. The owners are presently unwilling to provide further money, and the creditors are very concerned about the business' ability to continue operations with its current financial burden. The company's assets are worth considerably more as a going business than in a liquidation. Moreover, while barely insolvent in a balance sheet sense, the company is equitably insolvent and hence unable to operate with a positive cash flow on a go-forward basis. Some of the following questions may not be suited to a particular region. The respondent's answer should indicate why the question does not apply and what would be a more suitable question. Responses to the questions should also distinguish between what the law of their region provides and what occurs in practice, to the extent there is a divergence between the two.

1. What structure would relief from indebtedness take—a liquidation, reorganization, out-of-court workout, assignment for the benefit of creditors, receivership or government bailout (takeover)? Who would make that decision? Would creditors be in a position to control the choices for Heavy Duty? In responding, consider how that decision is made and the length of time it takes to make.
2. Assume a choice of structure for relief from indebtedness has been made. Who oversees the process of obtaining the requested relief— Heavy Duty, the secured creditor, the unsecured creditors, a judicial officer (judge, clerk), attorneys, accountants, business managers, a trustee? Stated differently, who are the players in the selected process, and what are their respective roles and functions? How, if at all, are the players compensated for their time? In answering, consider the experience and training of the players in the process and whether the choice and number of players is optimally suited for the tasks at hand.
3. Within the chosen structure, what are the relative priorities among the creditors (assuming there will be funds available for distribution)? Who gets paid and in what order and what amounts? In responding, consider whether the choice of priorities and the amounts to which a priority creditor is entitled are well chosen and whether the priority system operates effectively (efficiently, fairly)?
4. How are secured creditors treated within the chosen process for relief? Does a security interest survive the chosen process intact or are a secured

creditor's rights/interests affected in some way? Compare the treatment of a secured creditor experiencing default within and outside the selected process. Consider, among other things, the impact of a stay (if any), self-help collection measures, foreclosure and the time value of money.

5. What is the personal liability, if any, of the managers, officers, directors, and equity holders of Heavy Duty? Does the selected process affect any of these individuals prospectively in terms of future business ventures, holding government office, or voting in elections? Is there any risk of imprisonment? Could any personal financial liability lead such individual(s) to seek individual debt relief, and would any such liability be discharged in such a proceeding? Stated differently, can a business bankruptcy cause a ripple effect such that individuals within the business need to seek relief from indebtedness?

HEAVY DUTY BALANCE SHEET*

<u>Assets</u>		<u>Liabilities</u>	
Current Assets:		Current Liabilities:	
Accounts Receivable	\$ 500,000	Suppliers	\$ 3,000,000
Current Inventory	750,000	Taxing Authorities	1,000,000
Work-in-process	250,000	Employees/Retirees	250,000
Fixed Assets:		Long-Term Liabilities:	
Lease	\$ 1,000,000	Bank Lenders	\$ 5,000,000
Buildings (Net of Depreciation)	3,000,000	Owners	250,000
Machinery (Net of Depreciation)	2,000,000	Environmental Claim**	<u>—</u>
General Intangibles	<u>250,000</u>	Total Liabilities	\$ 9,500,000
Total Assets	\$ <u>7,750,000</u>	Owner's Equity:	
		Equity (Loss)	<u>(1,750,000)</u>
		Total Liabilities and Equity	\$ <u>7,750,000</u>

* Adjusted for inflation

** Unknown and unliquidated

CORPORATE QUESTIONS

Heavy Duty has come through its financial reorganization. It is now financially stable, and there is no known impediment to a business restructuring of this now healthy enterprise. The city government, family, workers, managers and executives are eager to assist in determining how to move Heavy Duty forward, thereby creating "Heavy Duty II." The physical plant needs renovation, the machinery needs maintenance and (eventually) re-tooling and replacement. The supply of necessary raw materials has been restored. There is still a market for Heavy Duty's products.

The following questions are, in essence, all pieces of one question: What options are available for restructuring the enterprise? In order to answer that question, we must consider the alternative forms of business organization, the various players and their roles in its organization, its possible capital structure, its options for capital formation and the role of liability (limited or otherwise) in choosing a business structure.

As with the bankruptcy hypothetical above, some questions may not be well suited to every region. The respondent's answer should indicate why the question does not apply and what would be a more suitable question. Responses to the questions should also distinguish between what the law of their region provides and what occurs in practice, to the extent there is a divergence between the two.

1. What options are available for organizing Heavy Duty II under the commercial laws—general or limited partnership? limited liability partnership? limited liability company? privately-held corporation? some other business organization? Which form of organization is preferable and why? What role does tax law play in influencing the choice of business form? Which actors in our hypothetical will make that decision and how will it be implemented?

2. Once a form of business has been chosen, who will participate in the organization and restructuring of Heavy Duty II—the family? lawyers? bankers? investment bankers? accountants? The City of Hope/National or State government? The courts? What roles will they play and what functions will they perform? How will they be compensated?

3. (a) What capital structure will/should Heavy Duty II choose? Of what kinds of securities will the capital structure be composed? Will the availability of a public securities market influence those choices?

(b) What options are there for raising capital? Are there legal constraints on investment from abroad? Whose approval is required to authorize the selling of equity interests? debt interests? Put another way, where will the money come from?

4. What role will personal liability play in influencing the choice of business structure? What liability will attach to the various constituencies that make up Heavy Duty II, e.g., the equity holders, the directors, the managers, officers, employees and creditors? To what kinds of liability are these actors exposed: are they personally liable for business obligations? Is that liability joint and several? Is there any potential criminal liability? What sorts of protection are available to these individuals? Can the relevant business agreements limit these individuals' liability? Will insurance be available to them? Against what liability? Who will pay for it? Is some personal liability mandatory under the relevant commercial laws?