

DEBTOR / CREDITOR

Final Examination

Professor Hurn

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Instructions: This examination is for three hours. It is fully “open book,” meaning you may refer to any written materials that you may have brought with you. However, you may not work with or consult any other person about your answers. Answer the multiple choice questions on the Scantron sheet provided and the short answers and essay in a Bluebook. Do not assume that familiar-looking questions are the same as those on old exams.

Unless otherwise indicated, assume all transactions occur in the USA in states with the uniform codes and statutes printed in your statutory supplement, with typical versions of other sorts of statutes. If something appears missing or mistaken, plainly state a corrective assumption and proceed with your answer

Remember to put your exam number on the answer forms and bluebooks.

Multiple Choice**(Up to 90 minutes)**

1. The difference between effective gifts *causa mortis* and *inter vivos* is:
 - a. The former requires donative intent before or simultaneously with delivery.
 - b. The latter is irrevocable.
 - c. Both a. and b. are correct.
 - d. Neither a. nor b. is correct.

2. Crook bought Alexandra’s valuable roll-top desk with a counterfeit cashier’s check. Crook quickly resold the desk to Bertha, the innocent proprietor of “Bertha’s Pretty Good Cash-and-Carry Used Furniture Store.” Bertha sold it to Carlotta for cash, but Carlotta did not have her truck with her. The next day, through an honest mix-up, Bertha’s partner sold the same desk to Diane for cash, who also left it for later pick-up. When all this is discovered, the desk is still in Bertha’s shop. Who owns the desk?
 - a. Alexandra because Crook had void title.
 - b. Carlotta because Crook had voidable title which became good on sale to Bertha.
 - c. Diane because Carlotta entrusted her goods to Bertha.
 - d. Diane because she was the last BFPV without notice.

3. Same facts as the previous question. One or both of Bertha’s customers necessarily must lose the desk. Her/Their best theory of recovery against Bertha will be
 - a. Negligence.
 - b. Conversion.

- c. Unjust Enrichment.
- d. Warranty.

4. When a client has the option of suing in Trover or in Replevin, s/he should generally prefer Replevin if:

- a. The market value of the misappropriated property is expected to be greater at the end of the trial than at the time of the misappropriation.
- b. The market value of the misappropriated property is less than the subjective value placed on it by the client.
- c. Replevin is preferable in BOTH situations.
- d. Replevin is preferable in NEITHER situation.

5. A gratuitous assignment is:

- a. Generally ineffective without a writing or detrimental reliance.
- b. Generally revocable without a writing or detrimental reliance.
- c. Revoked by a subsequent assignment for value.
- d. Both b and c are correct.

6. Assignments of contract rights NOT governed by UCC Article 9 fall under either the American Rule or the English Rule, depending on the state. Under the English Rule, when there are successive, irrevocable assignments of the same right, the owner is

- a. The first person to whom assignment is made.
- b. The first assignee to notify the obligor under the original contract.
- c. The last assignee to take without notice of any prior conflicting rights.
- d. The last assignee for value without notice of any prior conflicting rights.

7. Same subject. When assignments ARE governed by Article 9 and there are successive, irrevocable assignments of the same right, the owner is

- a. The first person to whom assignment is made.
- b. The first assignee to notify the obligor under the original contract.
- c. The first assignee to file in the Article 9 registry.
- d. The first assignee for value without notice of prior conflicting rights to file in the Article 9 registry.

8. You represent a major unsecured creditor of Peter Smith who does business as Pepperoni Pete's Pizza House (a sole proprietorship). Smith is insolvent. Yesterday he assigned all the equity in his non-exempt assets to a local accountant in trust for the benefit of his creditors. You've gotten a call telling you this and inviting negotiations for a work-out. Your client is furious and wants to seize assets. In this situation:

- a. The transfer is Fraudulent. You can set it aside and pursue any unencumbered assets.

- b. You and the other creditors can garnish the trustee in a collections priority- race.
- c. You can ignore the transfer and attach the property because this is a voidable preference preempted by the federal Bankruptcy Code.
- d. The assignment is effective and you have to deal with it.

9. One evening Mr. White, preparing to run his errands the next morning, filled out a deposit slip and put it in an envelope with his paycheck. The check was in normal form, saying "Pay to the Order of – White." He had endorsed the paycheck simply by signing his name on the back. His roommate, Mr. Black found it while snooping around White's desk. Persuading himself that White owed him money, Black took the check, signed his own name below White's, and cashed it at a Check Cashing service. White reported the check stolen and his employer stopped payment. When the Check Cashing service sues the employer for the full amount of the check

- a. Employer will lose because the Check Cashing Service is a holder in due course.
- b. Employer will lose because the check was order paper, not bearer paper.
- c. Employer will win because it stopped payment in time on a stolen check.
- d. Employer will win because you cannot get title from a thief.

10. Young Lawyer paid off his BMW automobile a year early. The bank sent him his certificate of title with the lien marked discharged. However, the bank did not include the original negotiable promissory note, which would have had another year to run. Shortly thereafter Young Lawyer got a letter from Old Lawyer stating that remaining payments on the loan should be made to his client, Friendly Factoring, Inc. Apparently through some mix-up the note had been included in a batch that was indorsed and sold to the factor when the bank decided to get out of the auto-loan business. There are no marks on the note to indicate payment. In a suit by the factor against Young Lawyer to collect on the note:

- a. Factor will win because it is a holder in due course.
- b. Factor will win because of the shelter principle.
- c. Factor will lose because final payment is a real defense.
- d. Factor will lose because it has no greater rights than the assigning bank.

11. Uncle cashed a check for his 17 year old nephew (who did not have a bank account). It was a check payable to nephew, signed by a friend and given to repay a loan. Nephew indorsed it and delivered it to Uncle. Uncle forgot it for a couple of months and then deposited it. The Friend was 21 years old. However, Friend's account has been closed, the check was returned dishonored. Uncle immediately demanded his money from nephew, who is stalling. Assuming he chooses to pursue the Friend for the money, Uncle:

- a. Will lose because an indorsement made by a minor is ineffective.
- b. Will lose because he deposited stale paper.
- c. Will win because he is a holder in due course.
- d. Will win because Friend's duty to repay the original loan was merely suspended.

12. A thief stole grain from the Original Owner, put it into the warehouse of an honest warehouseman in return for a negotiable warehouse receipt, and sold the receipt to an innocent grain processor. Processor presented the receipt and took delivery of the grain. When this is all discovered:

- a. The innocent processor is now the owner and the Original owner must sue the thief and warehouseman for conversion.
- b. The Original owner is still the owner and the innocent processor may sue the warehouseman on warranty of title.
- c. The Original Owner is still the owner and may replevy the grain, but the honest warehouseman has no liability.
- d. The innocent processor is now the owner, and the Original Owner's remedy is only against the thief.

13. Under the Uniform Fraudulent Transfer Act, in the absence of any Bankruptcy filings, which preferences are voidable?

- a. All preferences
- b. All preferences made while the debtor is insolvent
- c. Only Insider preferences.
- d. Only Insider preferences made while the debtor is insolvent.

14. Debtor is being sued for a large sum. Debtor had some valuable artwork worth about \$15,000 dollars. Debtor went to a friend who had always admired the art, explained his situation and indicated he would like to trade it for some unmounted jewels of equal value because they "would be easier to lose or mislay, if you know what I mean." Friend agreed and then later gave the artwork to an innocent museum. Debtor loses the lawsuit and no non-exempt property is found. If the transaction with Friend is discovered, under the UFTA:

- a. Friend is liable to the judgment creditor for \$15,000.
- b. Friend is liable to the judgment creditor for the whole amount of the plaintiff's judgment.
- c. Friend is liable to the judgment creditor for \$15,000 and the museum is liable for \$15,000 or return of the artwork.
- d. No one is liable to the judgment creditor because the first transfer was for fair value.

15. Debtor is being sued for a large sum. Debtor had some valuable artwork worth about \$15,000. Debtor went to a friend who had always admired the art, concealed his situation and said he would sell the art for \$2,000, which he claimed was his original cost. Friend agreed. Debtor loses the lawsuit and no non-exempt property is found. If the transaction with Friend is discovered, under the UFTA:

- a. Friend is liable to the judgment creditor for \$15,000.

- b. Friend is liable to the judgment creditor for \$13,000.
- c. Friend is liable to turn over the artwork to the judgment creditor.
- d. Friend is liable to turn over the artwork to the judgment creditor only if arrangements are made to return his \$2,000.

16. Which of the following kinds of liens capture property which the creditor may not have yet identified?

- a. Attachment Liens
- b. Federal Tax Liens
- c. Judgment Liens
- d. Both b. and c.

17. When assignments of accounts are governed by Article 9 and there are successive, irrevocable assignments of the same right, the party with priority is

- a. The first assignee.
- b. The first assignee to notify the obligor under the original contract.
- c. The first assignee for value without notice of prior conflicting rights to perfect under Article 9.
- d. The first assignee to perfect under Article 9 irrespective of notice.

18. The owner of a valuable book collection used it as collateral for a loan from a local bank. The bank followed all necessary formalities and properly perfected its security interest in the books by filing in the Article 9 registry. Then the owner wrongfully sold the books to the unsuspecting owner of a rare bookstore, took the cash, and fled to Paraguay. According to the loan agreement, this is a default permitting foreclosure. In an action by the bank to recover the books from the dealer

- a. The bank will win because it had a perfected security interest and there is nothing in these facts to defeat its rights.
- b. The bank will win because the owner's default made his/her title void.
- c. The dealer will win because s/he is a buyer in the ordinary course of business.
- d. The dealer will win because a security interest is subordinate to ownership.

19. Same facts as above except that, before the wrongdoing is discovered, the dealer sells all the books to a regular customer. In an action by the bank to recover the books from the customer

- a. The bank will win because it had a perfected security interest and there is nothing in these facts to defeat its rights.
- b. The bank will win because the owner's default made his/her title void.
- c. The customer will win because s/he is a buyer in the ordinary course of business.
- d. The customer will win because a security interest is subordinate to ownership.

20. The proper way to perfect a security interest in stock held in the debtor's brokerage account is to:

- a. Take possession of the certificates representing the shares.
- b. Secure a control agreement from the Issuer.
- c. Secure a control agreement from the broker.
- d. Either b. or c. is proper.

21. Top-line Limo, Inc. had several fairly new Lincoln Navigators in its fleet. Each was partially paid off, but not completely. Ford Credit Corporation held a security interest in each, properly perfected by notation on and possession of the Certificate of Title. Peter Plaintiff was a former employee with a substantial employment discrimination judgement against Top-line which he has discovered is not covered by insurance. Peter has gotten a writ of execution against the vehicles, perfected in accord with the local statute by a filing in the Article 9 registry. As the attachment triggered its default clause, Ford Credit has filed a replevin action to repossess and foreclose. Neither party has physical possession yet and the cases have been consolidated to determine their rights. On these facts

- a. Peter has no lien because replevin defeats execution.
- b. Peter has no lien because he has not gone through the Certificate of Title Process.
- c. Peter has a lien superior to Ford's because execution defeats replevin.
- d. Peter has a lien subordinate to Ford's, enforceable against any surplus produced by the foreclosure sale.

22. Acme Corporation owned land on which there was an old toxic waste dump. The state government spent considerable money on a successful clean-up and, pursuant to local statute, recorded a lien against the land to recover the cost of the work. In financial trouble, Acme did not pay the state, nor its other creditors, nor the IRS. Shortly after the environmental lien filing a major creditor had the property attached, and then the IRS recorded a federal tax lien. Six months later Acme filed for liquidation under Chapter 7 of the Bankruptcy Code. In relation to this property, who has the highest priority claim?

- a. The State.
- b. The Attaching Creditor.
- c. The IRS.
- d. The Trustee.

23. With the same facts, who has the second priority claim?

- a. The State.
- b. The Attaching Creditor.
- c. The IRS.
- d. The Trustee.

24. With the same facts, who had the third priority claim?

- a. The State.
- b. The Attaching Creditor.

- c. The IRS.
 - d. The Trustee.
25. In a judicial foreclosure proceeding interrupted by the filing of a Chapter 7 Bankruptcy, where it is unclear whether there will be any salvageable equity in the property, the Bankruptcy Judge may:
- a. Lift the stay and allow the creditor to proceed in state court, paying over any surplus to the estate.
 - b. Remove the proceedings to the Bankruptcy Court and complete them.
 - c. Remove the proceedings to the Bankruptcy Court and start over.
 - d. Any of the above.

Short Answers
(up to 30 minutes)

Briefly respond to the following questions. I am not seeking detail—just recognition of the issues. A couple of sentences could do, more than five or six is definitely too much.

1. You represent a Bank. The loan officer has just called you. They have a business customer who has a line of credit secured by a floating lien on present and after-acquired equipment. You know the lien was legally correct and properly perfected. Customer just called the loan officer to say the IRS recorded a tax lien against it. Loan officer says this is a good customer, there is a good-faith dispute about the taxes, and she doesn't see any business reason not to continue the relationship. Is there a legal hazard to the bank here? Why or why not?
2. Your client is a grain exporter. He has just gotten a call from a buyer in a foreign country demanding a partial refund because the grain was of allegedly inferior quality. Your client has been paid pursuant to a letter of credit after presenting the necessary documents, including a signed written statement that the goods conformed to the contract. There is no arbitration clause in the sales contract. What exposure, if any, does your client have.
3. You represent a Bank. Your client has recently had to call a loan on a small mechanical design firm. There wasn't much collateral, mostly computers, patents on some inventions, and the royalty streams from the licenses of the inventions. These were properly described in an effective security agreement and a financing statement filed in the Article 9 registry. The work-out was bitter, but ultimately the debtor signed a surrender agreement. The bank sold the computers and patents to a new firm and assigned it the license/royalty agreements. The loan officer has told you this story over lunch, expressing relief that it was all finished. Is there something you should warn your client about? If so, what and why?

4. The holder of a first mortgage has notified your client of a foreclosure sale. Your client holds a properly perfected mechanics lien on the property for substantial repairs performed after the mortgage was recorded. There are no unpaid real estate taxes or other liens. Your client is firmly convinced that the property is worth considerably more than the outstanding balances due on the two liens. Assuming this is true, briefly explain your client's options.

Essay (Up to 60 minutes)

Big Boy Learning Tools, Inc. was a promising start-up company based on a uniquely designed computer authoring system which would enable any user to easily write interactive educational tutorials, games, cartoons, training exercises, etc. The corporation had been assigned the copyrights to all the software by its founders. The company planned to sell a disk embodying the authoring software (with a non-exclusive license to use it) to customers who would find them through the internet or advertising in print media, order through the internet or by phone, pay by credit card, and take delivery by mail or Federal Express. The item would sell for \$99.00.

Big Boy bought a small building near the Post Office, financing it with a mortgage held by the Bank and properly recorded. The Bank also advanced them a working capital loan, secured by a lien on all their present and after acquired accounts, inventory, equipment, and general intangibles, properly created and recorded in the Article 9 registry. The Bank's security agreement covered future advances and any funds advanced to or on behalf of Big Boy by the Bank. The real estate and working capital loans had cross-default clauses.

Hewlett Packard sold them all their computer and CD burning equipment on credit, taking and properly recording a purchase money security interest. They also bought 20,000 blank CDs from Cheapo Disk Co., more than they needed at the time, but they got a quantity discount. Of course Cheapo took and recorded a PMSI in the CDs. Big Boy also had their building thoroughly rewired for their special needs. The electrician was a friend who took a spare Hewlett Packard Computer as partial payment, but also recorded a mechanics lien for the rest, just to be safe.

They started up and had a fairly lively business, but not nearly enough to meet their goals (or to pay their mounting bills). Then Big Boy got a major contract. Chrysler Credit Corporation wanted them to design and produce disks for a training program for all Chrysler credit managers in the country. They hadn't intended to write programs for end users, but this was a huge opportunity, so they signed up. To insure against default, Chrysler Credit insisted on a Standby Letter of Credit from Big Boy's Bank undertaking to pay Chrysler \$100,000 if Big Boy failed to deliver workable disks according to the specifications within 30 days of the agreed contract date.

Trouble began almost at once. The Cheapo disks had a high rate of defects which appeared only after several hours of use. Big Boy faced many refund claims. The Chrysler training program was more complex than they had foreseen and they feared they might not be able to make their deadline. They were subject of terrible negative reviews in all the industry magazines. They had big, past due bills for advertising. They had gone without salary for three months.

Hoping to salvage something and get out, the founders re-assigned the copyrights to themselves in satisfaction of their foregone wage claims, recording this in the Copyright office. A week later Big Boy filed a Chapter 7 bankruptcy. There were 16,000 blank CDs left and 2,000 which had been printed with the authoring program. The Trustee immediately rejected the Chrysler Credit contract.

For each potential claimant, including the Trustee, please indicate what they can expect to get from any of the assets mentioned in the facts and, in the case of competing claims, indicate priorities.

End of Examination