

QUESTION 3

Constructor, Inc. is in the business of building custom homes. On March 1, 1995, Constructor obtained from Texas Bank a \$500,000 line of credit upon which he could draw for working capital. Constructor signed a security agreement granting Texas Bank a security interest in all of Constructor's currently-owned and after-acquired equipment, inventory and accounts receivable. The security agreement contained a clause reciting that it covered future advances made on the line of credit. Texas Bank properly filed financing statements in all the required public offices.

Most of the time after March 1995, the outstanding balance on the Texas Bank line of credit, taking into account periodic payments by Constructor and advances by Texas Bank, was about \$200,000.

In June 1998, Lumberjack sold Constructor \$90,000 worth of lumber on credit. The lumber became part of Constructor's inventory for use in the construction of homes in the Houston area. Constructor signed a security agreement granting to Lumberjack a security interest in the lumber and proceeds thereof. Lumberjack filed financing statements in the Harris County Clerk's office only. A few days before delivering the lumber to Constructor, Lumberjack delivered a letter to Texas Bank, describing the lumber, and advising Texas Bank that Lumberjack had sold the lumber to Constructor and was taking a security interest in the lumber to secure payment of the purchase price. Texas Bank received the letter but did not respond to it.

1. Which creditor, as between Texas Bank and Lumberjack, has a superior security interest in the lumber sold to Constructor by Lumberjack? Explain fully.

In July 1999, Constructor purchased two items of earth moving equipment from Mark: a grader and a bulldozer. The grader was purchased on credit extended by Mark, and Constructor signed a security agreement granting to Mark a security interest in the grader. Mark filed financing statements in all the required public offices.

The bulldozer was paid for with an advance from the 1995 Texas Bank line of credit.

In September 1999, Constructor sold the grader and the bulldozer to Odd Job Contractors, a company unrelated to Constructor.

2. If Constructor fails to pay Mark and defaults on its payments to Texas Bank, what rights, if any, do Mark and Texas Bank each have to repossess the grader and the bulldozer from Odd Job Contractors? Explain fully.

On October 1, 1999, another bank, Houston Bank, extended to Constructor a \$500,000 line of credit. Constructor signed a security agreement granting to Houston Bank a security interest in terms identical to those contained in Texas Bank's 1995 security agreement. Houston Bank properly filed financing statements in all the required public offices.

On October 2, 1999, Constructor paid off its running balance on its 1995 line of credit with Texas Bank. The Texas Bank line of credit remained open with a zero balance. On October 3, 1999, Houston Bank advanced \$200,000 to Constructor on its new line of credit. Houston Bank failed to obtain a release of Texas Bank's security interest.

3. Which creditor, as between Texas Bank and Houston Bank, has the superior security interest in Constructor's equipment, inventory, and accounts? Explain fully.

In December 1999, Constructor paid off Houston Bank and obtained a release of Houston Bank's security interest. In February 2000, Texas Bank advanced Constructor \$495,000 on the original 1995 line of credit.

In July 2000, Constructor borrowed \$100,000 from still another bank, Dallas Bank, and signed a security agreement granting to Dallas Bank a security interest in terms identical to those in the 1995 Texas Bank security agreement. Dallas Bank also properly filed financing statements in the required public offices.

- 4. Which creditor, as between Texas Bank and Dallas Bank, presently has the superior security interest in Constructor's equipment, inventory, and accounts, and what, if anything, could the bank with the inferior position have done to achieve a superior priority position? Explain fully.**

Questions 3 and 4 - U.C.C.

Problems common to both questions

(1) Poor penmanship. No matter how well the examinee knows the law and the answers, the exam answers must be communicated legibly. If the answer is not readable, the examinee may not get the score her knowledge might otherwise merit.

(2) Organization and reading comprehension. Read each question, and answer each question. Pay attention to the facts presented. Make sure you grasp all the relevant facts before writing your answer. Misreading the facts was the cause of numerous errors in the answers. Reading the fact situation several times before answering might have prevented many of the wrong answers offered.

It's helpful to answer each subpart to the question in the order presented. Also, be sure to answer each question; some examinees simply failed to answer one or more parts. Check to be sure the exam booklet contains an answer for each question.

(3) Dissertations. A dissertation on the general subject matter of the question (e.g. Article 9) is not necessary or helpful. It just takes up valuable time in taking the test and does not add point value for the examinee. Jump right in and answer the question asked.

Question 3 - U.C.C.

Part 1: Failure to understand priority rule PMSI (purchase money security interest vs. SI (security interest)). Failure to recognize PMSI and actual notice rule.

Part 2: Failure to understand priority rule (PMSI vs. SI). Failure to identify two separate pieces of machinery (1 bulldozer and 1 grader). Most common error was failure to distinguish between a BFP (bona fide purchaser) and BIOCB (buyer in the ordinary course of business). Some did not understand BIOCB rule.

Parts 3 and 4: Many examinees did not know the lapse or termination rule, or they misapplied it.

QUESTION 4

In August, 1999, Nan, Dr. Good's trusted office assistant of 15 years, eloped with her fiancé, Dan, and left town without notice. Nan took with her two pads of checks, one on Dr. Good's business checking account at Town Bank and the other on Dr. Good's personal account, also at Town Bank.

On their extended honeymoon, Nan and Dan began writing checks on Dr. Good's accounts. Nan wrote checks on Dr. Good's business account, forging his signature on two checks, one on September 7, for \$500, and the other on September 30, for \$800. She received cash for the checks at Seaside Bank, and the checks were paid by Town Bank and charged to Dr. Good's business account upon presentation by Seaside Bank. The forgeries would have been obvious if Town Bank had compared each signature with the one on the bank's official signature card, but it was Town Bank's practice, in keeping with industry standards, not to compare signatures on checks in amounts less than \$1,000.

The September 7 check was listed on Dr. Good's business account statement, which he received on September 24 but which he failed to review. He received his next business account statement on October 25, on which the forged September 30 check was listed. Dr. Good noticed the forged September 30 check and, in looking back, also noticed the forged September 7 check shown on the prior statement. He then realized that an entire pad of checks was missing.

On October 25, Dr. Good immediately called Town Bank, reported the forgeries, and demanded that Town Bank credit his account with the amounts of the forged checks. Dr. Good also delivered to Town Bank a written stop payment order on all the checks on the missing pad of business account checks. Dr. Good then realized that a pad of checks on his personal checking account was also missing but found no forgeries among checks listed on the statements on his personal account. On October 28, he called Town Bank to report the missing pad of checks and told the bank officer that he wanted to stop payment on all checks on that pad as well.

The bank officer assured Dr. Good that he would personally take care of ensuring that no checks written on the personal account from the missing pad would be paid and told him that there was no need for Dr. Good to send a written stop payment order. Accordingly, Dr. Good did not send a written stop payment order on the personal account checks.

On October 30, Nan forged another business account check in the amount of \$300. She cashed it at Ocean Bank, and it was paid by Town Bank upon presentation by Ocean Bank on November 1.

On November 1, Dan wrote a check for \$600, forging Dr. Good's signature on one of the checks on Dr. Good's personal account. It, too, was cashed at Ocean Bank and paid by Town Bank upon presentation on November 2.

What liability, if any, does Town Bank have to Dr. Good on:

- 1. The September 7 business account check for \$500? Explain fully.**
- 2. The September 30 business account check for \$800? Explain fully.**
- 3. The October 30 business account check for \$300? Explain fully.**
- 4. The November 1 personal account check for \$600? Explain fully.**

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Question 4 - U.C.C.

Parts 1 and 2: The most common problem for both of these questions was not addressing the Bank's obligations (duty to check signatures) and possible negligence of Dr. Good (bank statement rule, employee vs. former employee forgery, etc.) and instead analyzing the situation with holder in due course, not properly payable and presentment warranty considerations only. While some discussion might have been in order along these lines, answers often ignored the key issues presented.

Parts 1 and 2: Limitation of answer to forgery and authorized persons issues to exclusion of key issues addressed above.

Parts 1, 2 and 4: Often good reasoning was used with an incorrect conclusion being reached. The reasoning should be consistent with the conclusions reached; there were many instances of reasoning in one direction to a conclusion that abruptly departed from the reasoning. Others simply gave conflicting arguments and reached no conclusion at all.

Part 3: This question was generally answered correctly. Incorrect answers were nearly always the result of not reading the facts properly-- missing the fact that a written stop payment was timely offered by Dr. Good.

Part 4: A common error in the answer to part 4 was offering an absolute answer that, absent a written stop payment, Dr. Good would lose. Such answers offered no consideration of the possible effects the bank officer's assurances might have on the outcome due to possible estoppel considerations or the fact that the bank was generally aware that problems existed with the Dr.'s business account.

QUESTION 1

Bob manufactures and sells metal storage containers. In 1997, Bob borrowed \$100,000 for operating capital from his sister, Sue. To secure the loan, Bob signed a security agreement granting to Sue a security interest in “all existing and after-acquired inventory and equipment, including the equipment described on Exhibit A attached hereto.” The items listed on Exhibit A consisted only of the various pieces of machinery that comprised the Supercoat Painting Assembly owned by Bob. At the same time, Bob signed a financing statement which described the collateral as “the items described in the attached Exhibit A,” which was the same list that had been attached to the security agreement. Sue properly filed the financing statement, with Exhibit A attached, in the Office of the Texas Secretary of State.

In 1999, Bob moved his business to a new location and, to cover the cost of the move, he borrowed \$50,000 from Bank. In connection with the move, Bob purchased all new equipment, except that he retained and moved his existing Supercoat Painting Assembly to the new location. To secure the loan, Bob signed a security agreement granting Bank a security interest in “all existing and after-acquired inventory and equipment.” He also signed a financing statement which described the collateral in exactly the same language as it was described in the security agreement. Bank properly filed the financing statement in the Office of the Texas Secretary of State. Bank had searched the public records of UCC filings and had seen Sue’s financing statement, but had not read Exhibit A.

On January 15, 2000, Bob purchased on credit and took possession of a forklift from Carl’s Equipment Company (“Carl’s”). Bob signed a security agreement and a financing statement in favor of Carl’s properly describing the forklift as the collateral. Carl’s properly filed the financing statement in the Office of the Texas Secretary of State on January 25, 2000.

Dave’s Container Co. (“Dave’s”), a competitor of Bob, decided to go out of business and delivered all his unsold containers to Bob’s sales yard to sell under the terms of a valid consignment agreement. There were no signs or other indications that these containers were owned by Dave’s, nor were Bob’s creditors advised of the consignment arrangement, nor did Dave’s file a financing statement in any public office.

To facilitate the handling of his containers, Dave’s allowed Bob to use six carts, which Dave’s intended to keep and use in another business. Bob found the carts so handy that, when Dave’s truck driver came to pick them up, Bob turned over four of them. The driver took the four carts, and Bob kept the other two for his own use.

Bob has now defaulted on all his debts. His business assets consist of:

1. The Supercoat Painting Assembly;
2. The equipment Bob acquired when he moved to his new location in 1999;
3. The unsold inventory of containers manufactured by Bob;
4. The forklift;
5. The unsold containers consigned by Dave’s; and
6. The two carts Bob had kept.

As among Sue, Bank, Carl’s, and Dave’s, which has the superior interest in each of the items listed above? Explain fully.

Question 1 - UCC

- The problems noted among the poorer answers to question 1 concerning secured transactions included:
- Confusion about purchase money security interests ("PMSI"), bona fide purchasers and holders in due course
- Misidentifying PMSI
- Misunderstanding of priority rules: perfected security interest vs. attached security interest
- Failure to understand super-priority for PMSI
- Failure to understand distinction between attachment and perfection
- Failure to understand distinction between security agreement and financing statement
- Failure to understand requirements for perfection

QUESTION 2

David was the treasurer of Widget, Inc. and was authorized to sign checks on Widget's account at State Bank. David opened an account at National Bank in the name of ABC Co., a non-existent company, and presented National Bank with a fictitious assumed name certificate that showed falsely that he was the sole proprietor of ABC Co. National Bank assumed the certificate was authentic.

David then wrote a check in the amount of \$10,000 payable to ABC Co. drawn on Widget's account at State Bank. He endorsed it and deposited it in the new account at National Bank. The check was paid by State Bank upon presentment.

When he learned of an upcoming outside audit of Widget's books, David decided he should leave town. He withdrew all the funds from the ABC Co. account at National Bank and closed the account.

Before leaving town, David wrote a check for \$700 on Widget's account, payable to State Bank. He used this check to obtain a \$700 cashier's check from State Bank payable to Speedy Moving Company. He gave Speedy the cashier's check in payment for moving his belongings to a distant state. Speedy did not know there was anything unusual about David's payment.

The next day, Widget learned of David's embezzlement and, before Speedy cashed the \$700 cashier's check, Widget requested that State Bank stop payment on the cashier's check.

- 1. What rights, if any, does Widget have against State Bank and National Bank to recover the \$10,000 paid on the check to ABC Co.? Explain fully.**

- 2. Is State Bank obligated to stop payment on the \$700 cashier's check, and if it does, what liability, if any, does State Bank have to Speedy? Explain fully.**

Question 2 - UCC

On Question 2, poorer performances were consistently due to a few common errors.

Part 1. The rights Widget, Inc. has against each of the banks:

Instead of consideration of fictitious payees, the imposter rule, holder and indorsement issues, or employer entrustment, many examinees only analyzed the question as a forgery or a bank statement rule matter. Often this resulted in no consideration of Widget's culpability.

Many answers offered reasonably correct conclusions with little or no indication of how the answer was reached.

Examinees sometimes concluded that bank liability (for one or both banks) existed by applying duties of care that went beyond those that actually exist. For example, while analysis of National Bank's duty of care in setting up ABC's account was proper, some examinees stated that National Bank had an absolute duty to check into the existence of ABC, including checking with the Secretary of State's office. Since the facts stated that ABC was a sole proprietorship, such a check would have revealed nothing, and answers like this often neglected to address what the industry custom might be.

Often such answers also said that State Bank was liable because it should have checked signature cards and questioned a \$10,000 check. While in some instances questioning such a large check might be in order, that is not an absolute rule. There was no penalty for arguing that further inquiry was warranted if such a large check was out of the ordinary. However, some examinees incorrectly stated that a Bank had a duty to call a customer about every check that was above some specified amount. Lastly, a check of the signature card would have revealed only an actual authorized signature and would not have offered any notice that anything was out of the ordinary.

Part 2. Stop payment on the cashier's check and State Bank's liability to Speedy Moving:

By far the most common mistake was not addressing the call of the question. While the question addressed stopping payment on the cashier's check, many answers addressed only Widget's ability to stop payment on the check that its treasurer wrote on Widget's account. That analysis often turned on whether written vs. oral notice had been given, without adequate discussion of the special significance of a cashier's check or Speedy's status as a holder or holder in due course.

July 2001

QUESTION 11

Kelly, owner of Kelly's Retail Store, contracted with Super Care Moving Company ("Super Care") to move her merchandise to a new store location. On March 1, 2001, Super Care completed the move and agreed to accept payment in the form of a promissory note from Kelly.

Kelly properly executed and delivered to Super Care a promissory note payable to the order of Super Care in the amount of \$3,000, interest-free, and due and payable on July 2, 2001.

The day after the move, Kelly discovered that Super Care, through its negligence, had lost a crate containing \$2,000 worth of Kelly's merchandise. Super Care's documents inventorying the move establish beyond dispute that the crate was lost and that the amount of the loss is \$2,000.

With these basic facts as the background, assume the following scenarios:

Scenario 1: On July 2, 2001, Super Care presented the note to Kelly and demanded payment. Kelly tendered \$1,000 and refused to pay any more.

Scenario 2: Assume instead that Super Care owed Henry \$2,500 for some equipment Henry had sold Super Care. Henry agreed to accept Kelly's note in full satisfaction of that debt. Super Care indorsed the note by signing it on the back and delivered it to Henry, who accepted it without knowledge of the dispute between Kelly and Super Care. On July 2, 2001, Henry presented the note to Kelly and demanded payment. Kelly, citing the \$2,000 loss caused by Super Care, tendered \$1,000 and refuses to pay any more.

Scenario 3: Assume instead that Super Care owed Allen \$2,700 for a truck Allen had sold to Super Care. Allen agreed to accept Kelly's note in full satisfaction of that debt. On July 16, 2001, Super Care indorsed the note by signing it on the back and delivered it to Allen, who accepted it without knowledge of the dispute between Kelly and Super Care. On July 17, 2001, Allen presented the note to Kelly and demanded payment. Kelly refused to pay any amount.

What are Kelly's obligations on the note in each of these three scenarios? Explain fully.

Question 11 – UCC

Common problems observed among the less successful answers included the following: Some examinees seemed unclear as to the status, rights and interests of holders, bona fide purchasers and holders in due course. Apparently, a number of examinees had difficulty distinguishing notes from checks. Other examinees incorrectly suggested that the original payee on a promissory note was a holder in due course. A few examinees had difficulty differentiating between real and personal defenses or did not seem to understand the application of real and personal defenses. In some instances, examinees did not demonstrate sufficient understanding of the distinction between a promissory note and a security agreement. Generally, it is helpful to answer the parts of a question in the order asked and to address the call of the question without adding general discussion of other aspects of commercial law.

QUESTION 12

Ray contracted with Diane for the construction of a new den addition to his home in Centerville, Leon County, Texas. To secure his obligation to pay Diane, Ray encumbered his home with a construction mortgage in favor of Diane. Diane properly filed the mortgage in the Leon County Clerk's Office on July 2, 2001.

On July 10, 2001, Ray purchased a television set from Enco, Inc., a Delaware corporation with a store in Centerville. As he told Enco, this television set was to be installed in a specially designed wall enclosure in his new den at home. To finance the purchase, Ray signed an installment sales contract combined with a security agreement granting Enco a security interest in the television set. Enco did not file any financing statements relating to this television set.

On July 12, 2001, Diane bolted the television set to the wall and then surrounded it by a brick enclosure. To remove the set, it would be necessary to tear apart the brick enclosure. Diane then went on to complete the den construction.

Also on July 10, 2001, Ray purchased from Enco a DVD player that, as he told Enco, was for the waiting room at Car Wash, a sole proprietorship owned and operated by Ray. To finance this purchase, Ray signed another installment sales contract combined with a security agreement granting Enco a security interest in the DVD player. On July 14, 2001, Enco properly filed a signed financing statement relating to the DVD player with the Texas Secretary of State.

Ray put the DVD player in the Car Wash waiting room so his customers could watch movies while waiting for their cars but soon determined that it was not a good idea because the customers were lingering longer than they should. Joe, a customer who had no actual knowledge of Enco's security interest, offered to buy the DVD player, and Ray sold it to him on July 20, 2001.

On July 23, 2001, Enco borrowed operating capital from Federal Bank. To secure the Federal Bank loan, Enco signed a valid security agreement granting Federal Bank a security interest in, "All chattel paper owned by Enco," and authorizing Federal Bank to sign and file financing statements in connection with the security agreement. The "chattel paper" in question consisted of the installment sales contracts combined with security agreements held by Enco from its customers.

Federal Bank promptly and properly completed and signed the necessary financing statement forms relating to its loan to Enco. Without having Enco sign the financing statement forms, Federal Bank filed them with the Texas Secretary of State.

Although Enco delivered most of the "chattel paper" to Federal Bank, including the installment sales contract that Ray had signed for the DVD player, Enco inadvertently neglected to deliver the installment sales contract Ray had signed for the television set.

Ray has defaulted on his payments to Enco and Diane, and Enco has defaulted on its obligations to Federal Bank.

- 1. As between Diane and Enco, who has the priority interest in the television set? Explain fully.**
- 2. As between Enco and Joe, who has the priority interest in the DVD player? Explain fully.**
- 3. Does Federal Bank have a perfected security interest in the installment sales contracts signed by Ray for the DVD player and the television set? Explain fully.**

Question 12 – UCC

On subpart #1 of Question 12: Many examinees incorrectly argued that since a television is a consumer good, it could not become a fixture, regardless of its attachment to the realty. Many less accurate answers asserted that if Enco had filed a subsequent fixture filing within twenty days of the television's purchase, Enco would have had priority over Diane's construction mortgage--regardless of any other facts. In this case, Diane's construction mortgage had priority once the television became a fixture, and any subsequent filing by Enco would not have changed Diane's priority. It was often incorrectly stated that purchase money security interests always take priority over any other lien or interest in all situations. This fact situation presented one of the exceptions to this generality.

On subpart #2: Some examinees incorrectly concluded that Joe took the DVD player free and clear because he was *not* a buyer in the ordinary course of business. The fact that he was not a buyer in the ordinary course of business helps to reach the opposite conclusion. Other examinees who had difficulty classified Joe as a bona fide purchaser or a holder in due course and, based on that, they concluded that he must have taken free and clear of any security interests. Because this was not a transaction in the ordinary course of business, Joe was neither a bona fide purchaser nor a holder in due course. Many of the less successful answers invoked the "garage sale" or "e-bay" rule and deemed the sale between Ray and Joe to be a consumer-to-consumer transaction. This was inaccurate because Ray was not a consumer and Joe was buying from Ray as the owner of a car wash, not in the business of selling electronics.

On subpart #3 of Question 12: Few examinees explained that the filing was faulty because it was filed in Texas, not Delaware where Enco was incorporated. Many examinees who had difficulty with this subpart asserted that failure to have Enco sign the financing statements was fatal. In general, the revisions to Article 9, effective July 1, 2001, no longer require a Debtor's signature on a financing statement. Instead of staying within the parameters of the question (Does Federal Bank have a perfected security interest in the installment sales contracts?), a number of answers discussed priority issues between all of the parties rather than addressing Federal Bank's perfection issues.

QUESTION 9

Decor, Inc., a Delaware corporation, operates a retail store in Dallas, Texas. Decor sells decorative items for the home.

In August 2001, Decor bought 175 lamps for its inventory on credit from Larry's Lamps. The lamps were retained in Larry's warehouse for later delivery to be directed from time to time by Decor. Decor properly completed and authenticated a sales contract combined with a security agreement, granting Larry's a security interest in the lamps. Larry's, however, neglected to file a financing statement.

Also in August 2001, Decor bought on credit and took delivery of 50 birdbaths from Carrie. In connection with this transaction, Decor properly completed and authenticated a sales contract combined with a security agreement, granting Carrie a security interest in the birdbaths. Carrie timely filed a financing statement in the office of the Secretary of State in the State of Delaware. The financing statement described the birdbaths and included all required information regarding the parties. The security agreement also described the birdbaths and contained a provision by which Decor purported to waive notice of default before repossession and also to waive any damages arising from any repossession by Carrie.

In September 2001, Sam bought 75 lamps from Decor to be delivered to Sam directly from Larry's warehouse. The 75 lamps were identified and put in a separate section of the warehouse. Sam paid Decor for the lamps. Decor used the proceeds of the sale to pay the full amount due Carrie on the purchase of the birdbaths. Consequently, Decor defaulted on its obligations to Larry's, so Larry's refused to deliver the 75 lamps to Sam.

Carrie inadvertently credited the payment from Decor to the wrong account so that it appeared on Carrie's books that Decor was in default. Carrie's hired Reba's Repo Service, an independent reposessor, to repossess the birdbaths from Decor.

After dark one evening, Reba went to Decor's store and, finding that the birdbaths were on display in front of the store, loaded them in a trailer. The store manager, who was just closing up the store, approached Reba, who told him she was repossessing the birdbaths. When the manager tried to stop her, protesting that Carrie had been paid, Reba shoved him and jumped into her truck. The manager pursued her, and, as Reba swerved toward the manager to scare him away, the trailer overturned, and all the birdbaths fell out and broke to pieces.

Decor sues Carrie, claiming wrongful repossession and damages to the birdbaths under the Texas Uniform Commercial Code, Chapter 9. Carrie asserts as defenses that (a) she was not required to give notice before attempting to repossess the birdbaths, (b) she is not responsible for Reba's actions and (c) Decor waived any damages that might occur in connection with a repossession.

Sam demands that Larry's deliver the 75 lamps to him.

- 1. As between Larry's and Sam, which has the superior rights to the 75 lamps? Explain fully.**
- 2. What arguments should Decor make in support of its claims against Carrie, and what is the likelihood of success of each of Carrie's defenses? Explain fully.**

Question 9 – UCC

Part I: Many examinees did not properly recognize that possession equaled perfection of Larry's Lamps' security interest. It was often asserted that Larry's Lamps' failure to file a financing statement (regardless of its possession of the lamps) was fatal to Larry's holding any priority status in the lamps. Sam's status as a "buyer in the ordinary course of business" was sometimes erroneously treated as being superior to all other interests, without regard to any analysis of the potential priority issues that existed.

Part II: Some less successful answers failed to recognize that no actual default existed and therefore Carrie would ultimately bear some liability due to her erroneously instituting repossession efforts. Some examinees limited their analysis to incorrectly determining that Carrie improperly filed the financing statement in Delaware. After making such a determination, the answers were often limited to asserting that since Carrie did not have a perfected security interest, she could not properly repossess the birdbaths - with no consideration given to Carrie's asserted defenses. Many examinees seemed to believe that notice of repossession was not only required by law, but also that it could not be waived. This resulted in incorrect assessments of Carrie's defense of waiver of notice. Some examinees failed to address the defense related to the waiver of the damages contained in the security agreement.

QUESTION 10

Ana contracted with Lou for repairs on her home. While he was working next to the kitchen window, Lou saw Ana lock her checkbook in a cabinet and put the key in a cookie jar. Later and without Ana's knowledge, Lou slipped into the kitchen, used the key to unlock the cabinet, stole a blank check, locked the cabinet, and replaced the key.

Ana maintained her checking account at Local Bank. She gave Lou a check payable to Lou for \$800 in payment for the repairs. Lou altered this check by changing the written word "eight" to read "eighteen" and the number "\$800" to read "\$1,800."

Lou then filled out the stolen check, making it payable to himself in the amount of \$500. He signed Ana's name, skillfully copying Ana's signature from the \$800 check so that there was nothing unusual about the appearance of the \$500 check. Lou indorsed both checks and deposited them in his checking account at National Bank.

National Bank presented the checks to Local Bank in the ordinary course of business. Local Bank paid the \$500 check. However, an employee of Local Bank noticed the alteration of the check for \$1,800 and phoned Ana to ask her about it. Ana was out of town for a few days, so the Local Bank employee left a voicemail message. The check for \$1,800 was set aside and not paid. Local Bank did nothing to notify National Bank that it was holding up payment on the \$1,800 check.

Five days later, when Ana returned home, she listened to the message and reviewed the checking account statement she had received from Local Bank during her absence. She immediately phoned Local Bank and reported that the \$500 check, which was among the canceled checks enclosed with the statement, had been stolen and forged. In response to the voicemail message, she reported that the \$1,800 check had been altered and said she had written it for \$800.

In the meantime, National Bank had credited Lou's account with \$2,300. Four days after National Bank had forwarded the two checks to Local Bank for collection, Lou closed his National Bank checking account and withdrew all funds, including the \$2,300. Lou has departed, and his whereabouts are unknown.

- 1. Is National Bank entitled to recover \$1,800 or any other amount from Local Bank? Explain fully.**
- 2. Is Local Bank entitled to recover from National Bank the \$500 paid on the forged check? Explain fully.**
- 3. Is Ana entitled to have Local Bank restore the \$500 to her account? Explain fully.**

Question 10 – UCC

Problems noted among the less successful answers to this question included (1) focusing the discussion on holder-in-due-course when the question did not address this; (2) inadequate understanding of the difference between a note and a check; (3) confusion as to maker, payor and payee; (4) misunderstanding recoupment; (5) misunderstanding of presentment warranties; (6) misapplying negligence, comparative fault and equitable relief; and (7) confusion over and misidentification of the parties.

QUESTION 5

Bob gave Al a promissory note for \$500 in exchange for a Rolex watch, which, unknown to Bob, did not keep proper time. The note was undated, did not mention any interest rate, and read, "I promise to pay to the order of Al the sum of \$500. /s/ Bob."

Al, intending to give the promissory note to his son as a gift, indorsed it in blank, "/s/ Al." Before he was able to deliver it to his son, Al lost the note.

Cal, a stranger, found the note. He transferred possession of it to Tom in exchange for \$350 cash. Tom did not know how Cal acquired the note, and Cal has disappeared.

- 1. Against whom, if anyone, can Tom collect on the note? Explain fully.**
- 2. What claims or defenses, if any, can Bob assert against Al and Tom? Explain fully.**
- 3. What rights, if any, does Al have against Tom as to the note? Explain fully.**

Question 5 – UCC

No comments posted.

QUESTION 6

Bob's Builders, Inc., ("BBI") is a Texas corporation engaged in a small home construction business. In December 2001, BBI borrowed \$500 from Travis and promised to repay it in six months. BBI gave Travis BBI's portable cement mixer to hold until the loan was repaid. Travis has possession of the cement mixer.

On January 5, 2002, BBI borrowed \$5,000 from Bank to finance a new job BBI had undertaken. BBI signed a promissory note and security agreement giving Bank a security interest in "all of BBI's equipment and tools now owned or hereafter acquired." At the time, BBI owned the cement mixer and sundry construction tools. On the same day, Bank properly perfected its security interest by filing a financing statement with the Texas Secretary of State.

On March 5, 2002, BBI reorganized and changed its name to House Levelers, Inc. ("HLI"), a Texas corporation. At the same time, it filled out the necessary paper work and changed the name on its checking account at Bank from BBI to HLI.

Also on March 5, 2002, under its new name, HLI paid cash for and took delivery from Jacking Devices, Inc. ("JDI") a set of jacks to be used for lifting houses off their foundations.

On April 5, 2002, HLI purchased some new drilling equipment on credit from Drillco. HLI gave Drillco a promissory note and a security agreement covering the drilling equipment. Drillco properly perfected its security agreement on April 6, 2002 by filing a financing statement with the Texas Secretary of State.

On July 10, 2002, HLI purchased a used grinding machine on credit from Grindco. HLI gave Grindco a promissory note and a security agreement covering the grinding machine. However, Grindco failed to file a financing statement.

It is now July 15, 2002, and HLI cannot pay its bills.

As among Travis, Bank, Drillco, and Grindco, which creditor's security interest, if any, has priority in the following items:

- (a) The portable cement mixer? Explain fully.**
- (b) The sundry construction tools? Explain fully.**
- (c) The set of jacks? Explain fully.**
- (d) The drilling equipment? Explain fully.**
- (e) The grinding equipment? Explain fully.**

Question 6 – UCC

Many examinees used the term "purchase money security interest" in ways that suggested a poor understanding of the meaning of the term. Less successful answers also tended to indicate misunderstandings as to the following:

- Possession is a valid method of perfection. It does not require filing. One in possession remains perfected as long as he keeps possession.
- A security agreement may have an "after-acquired" property clause.
- Equipment used to conduct one's business is not necessarily inventory.
- The holder of a Purchase Money Security Interest ("PMSI") in equipment is not required to notify anyone of its interest.
- A loan secured by collateral is not a PMSI.
- Used goods may be the subject of a PMSI.
- A seller who has a PMSI has 20 days from the date of sale to perfect its interest.
- A secured party loses perfection, but not its interest, four months after the date of a "seriously misleading" name change.
- A name change does not retroactively erase a party's perfected interest.

QUESTION 7

Phil told Joe, the sole proprietor of Joe's Pre-Owned Trucks, he was looking for a used truck he could purchase for under \$1,000. He told Joe he needed a vehicle he could use exclusively for towing his boat and trailer the 500 yards between his cabin and the access ramp at the water's edge.

Joe said he had no trucks under \$1,000 but, although he does not normally deal in anything other than trucks, he had recently taken as a trade-in an ATV (All Terrain Vehicle, a four-wheeled motorcycle). Joe showed Phil the ATV and said, "It's been sitting in the shed for two weeks, and no one has made an offer. It might be just what you need. I can let you have it for \$800." Phil did a cursory inspection of the ATV, started it up, and, satisfied that it ran, purchased it for \$800.

The next day, Phil used the ATV to tow the boat and place it in the water. Later, when Phil was pulling the boat out of the water, the transmission of the ATV failed. His mechanic inspected it and found that one of the seals had rotted, allowing the transmission fluid to leak out. The mechanic said the leak should have been obvious even before the failure because there were oily spots on the transmission housing and there would have been a puddle of transmission fluid on the ground wherever the ATV had been parked. When Phil checked the place where he had parked the ATV overnight, he saw the puddle.

The old transmission cannot be repaired. A rebuilt transmission will cost \$850. The value of the ATV in its current condition is \$100 for its parts.

- 1. What claims, if any, might Phil assert against Joe for breach of warranty under Article 2 of the Uniform Commercial Code (UCC)? Explain fully.**
- 2. What defenses, if any, can Joe assert against each claim? Explain fully.**
- 3. What is the measure of damages under the UCC for Phil's breach of warranty claims? Explain fully.**

Question 7 – UCC

Comments are not presently available.

QUESTION 8

Clarence employed Bobbie Johnson as a secretary/bookkeeper in his business. Part of Bobbie Johnson's job was to gather the bills once a week, prepare for Clarence's signature the checks to pay the bills, record them on the stubs in the checkbook, and mail out the checks. She was not authorized to sign checks.

Clarence's bank, Bank, regularly sent out the monthly checking account statements at the end of each month and Clarence would receive them on the 3rd day of the following month. Bank would list on the monthly statements the paid checks showing check number, date of payment, and amount. For the type of account Clarence had, Bank did not return the cancelled checks with the statements. Clarence would customarily review and reconcile the statements within two weeks after he received them.

On June 1, 2002, Clarence left on an extended vacation and returned on August 30, 2002. When he returned, he found a letter of resignation from Bobbie Johnson.

On October 2, 2002, Clarence reviewed the May 31, June 30, July 31, and August 31 bank statements that had been received in his office on June 3, July 3, August 3, and September 3, respectively. He became suspicious when he noticed the following four checks, each in the amount of \$2,500, that had not been recorded on the check stubs:

- Check no. 100, paid by Bank on May 15;
- Check no. 200, paid by Bank on June 15;
- Check no. 300, paid by Bank on July 15; and
- Check no. 400, paid by Bank on August 15.

When he called Bank on October 2 to inquire about those checks, he learned that they were all payable to Bobbie Johnson. After examining the checks Clarence concluded that Bobbie Johnson had forged his signature. Clarence's banker explained that Bank had not discovered the forgeries because, due to the volume of checks paid every day, Bank's policy was to verify signatures only on checks in excess of \$5,000. Clarence demanded that Bank credit his account with the amount of all four checks, \$10,000. Bank credited his account with \$2,500 for check no. 400 paid on August 15 but refused to credit any of the other amounts.

- 1. Under the UCC, what are Bank's obligations to Clarence with respect to the checking account, and did Bank breach any of those obligations? Explain fully.**
- 2. Under the UCC, what are Clarence's obligations to Bank with respect to the checking account, and did Clarence breach any of those obligations? Explain fully.**
- 3. What amount, if any, is Clarence entitled to recover from Bank, and how will the amount be determined? Explain fully.**

Question 8 – UCC

Comments are not presently available.

QUESTION 9

On June 1, Jake purchased from Dealer, and took possession of, a portable cement mixer for use in Jake's Texas home remodeling business, which he operated as a sole proprietor. The price was \$2,000, to be paid in installments, and Jake gave Dealer a security interest in the cement mixer. Dealer perfected the security interest by properly filing a financing statement.

The promissory note Jake signed provided for accelerated payments in the event of a default, and the security agreement contained a provision by which Jake waived notice of sale in the event of repossession by Dealer.

On July 1, Jake obtained a business loan from Bank and gave Bank a security interest in all present and after-acquired equipment. Bank perfected its security interest by properly filing a financing statement.

Jake failed to make any payments to Dealer, and, on September 1, Dealer properly notified Jake of the default, accelerated the indebtedness in accordance with the note and security agreement, and demanded that Jake return the cement mixer. Jake refused. Dealer then contracted with Speedy Repo, Inc. to repossess the cement mixer.

Anticipating trouble, Speedy Repo hired Officer, a local off-duty police officer, to accompany Speedy Repo's employee in carrying out the repossession. They found the cement mixer on a public street in front of a house where Jake was repairing the driveway. As they were hitching the cement mixer up to Speedy Repo's truck, Jake confronted them and told them to leave it alone and go away. Officer displayed his police badge and revealed his service revolver and told Jake that they were authorized by Speedy Repo to take the cement mixer. Jake, afraid of a violent confrontation, shrugged his shoulders and walked away.

A week later, Dealer sold the cement mixer for \$1,400. Dealer, relying on the waiver contained in the security agreement, did not give notice of the sale to Jake. Nor did Dealer give notice of the sale to Bank because Dealer had no actual knowledge of Bank's security interest. Dealer now seeks to recover from Jake the \$600 balance owed.

- 1. What rights, if any, does Jake have against Dealer, Speedy Repo, or both arising from the way the repossession was carried out? Explain fully.**
- 2. Does Dealer have a right to a deficiency judgment against Jake, and, if so, how should the amount be calculated? Explain fully.**
- 3. What rights, if any, does Bank have against Dealer? Explain fully.**

Question 9 – Uniform Commercial Code.

Most examinees correctly answered that a secured party had the right to repossess the collateral after default but that a breach of the peace occurred and that both Dealer and its agent, Speedy Repo, would have liability. Some examinees came up with the correct result that Dealer may be entitled to a deficiency judgment but for the wrong reason, i.e. because the waiver was effective. Others who correctly answered that the waiver was ineffective erroneously answered that this would prevent Dealer from obtaining a deficiency.

They failed to note that a deficiency is not barred in a commercial transaction.

Many examinees erroneously thought that Bank's status as a junior lien holder meant that Bank was not entitled to notice from Dealer and failed to discuss Bank's rights to actual damages if such could be shown.

QUESTION 10

John purchased a sofa from Carol. On January 1, 2002, John gave Carol a check for \$500 payable to the order of Carol. The check was drawn on John's account at Big Bank. He postdated the check to January 15, 2002 because he did not have enough money in the account to cover it, but he intended to deposit sufficient funds by January 15. John did not notify Big Bank that he had postdated the check. In addition, John wrote on the face of the check the words "NON-NEGOTIABLE."

Thereafter, the following events occurred:

- On January 1, Carol indorsed the check, "Pay to the order of Robert as agent for Carol, /s/ Carol." Robert had agreed that he would use the \$500 to pay for Carol's yard work while she was on vacation.
- On January 3, Robert indorsed the check, "Pay to the order of Fred, /s/ Robert," in exchange for a Super Bowl ticket having a face value of \$250.
- On January 4, Fred offered the check to Susan for a discount. Susan gave Fred \$350, and Fred indorsed the check, "Pay to the order of Susan without recourse, /s/ Fred."
- On January 4, Susan indorsed the check, "For deposit only, /s/ Susan" and deposited it at Hometown Bank, which credited her checking account for \$500.
- On January 8, Big Bank dishonored the check because there were insufficient funds and returned it to Hometown Bank, which debited Susan's account for the \$500 and returned the dishonored check to her.

1. **Was John's check a negotiable instrument? Explain fully.**
2. **What liability, if any, do John, Carol, Robert, and Fred have to Susan on the check? Explain fully.**
3. **Does John have a cause of action against Big Bank for dishonoring the check before January 15, 2002? Explain fully.**

Question 10 – Uniform Commercial Code.

Many examinees did not discuss all of the elements of negotiability in explaining whether the check was negotiable. Some examinees erroneously answered that writing the words “non negotiable” on a check or that post dating the check made it non negotiable. There is no requirement that holders must seek recovery in any particular order from indorsers. Robert’s breach of agency duties that he owed to Carol did not cut off or affect any of the subsequent takers’ holder in due course status. There was some misunderstanding on the holder in due course concept, i.e. it does not insure against indorser liability nor does it cut off the liability of subsequent indorsers. Some examinees failed to explain that John had failed to give the bank any advance written notice requesting that the check not be paid until the post dated date. Had he given the Bank such notice, the Bank would have liability.

QUESTION 5

In January, Zeb purchased an abandoned gas station (the lot and the improvements upon it) in Dallas, Texas that he intended to remodel into a convenience store.

On May 1, Zeb borrowed \$50,000 from Bank to finance the remodeling, and, to secure this debt, he gave Bank a deed of trust (construction mortgage) that was properly recorded in the real property records of Dallas County, Texas on May 2.

On June 1, Zeb bought 150 sheets of wallboard for \$2,000 on credit from Gypsum Co. He intended to use the wallboard for partitioning rooms in the remodeled store. Gypsum Co. secured this debt with a security agreement in which Zeb gave a security interest that was reflected in a document describing the debtor, the secured party, the amount of and the type of collateral (wallboard) and the legal description of the gas station property. On June 3 Gypsum Co. filed the document in the real property records of Dallas County, Texas. The wallboard was installed later during the month of June.

On June 15, Zeb bought two sinks and commodes for \$1,000 on credit from A-One Plumbing for the restrooms in the building. A-One secured this debt with a security agreement in which Zeb gave a security interest that was reflected in a document describing the debtor, the secured party, the amount and type of collateral (the sinks and commodes), and the legal description of the gas station property. On June 20, A-One filed the document in the real property records of Dallas County, Texas. The sinks and commodes were permanently installed on June 18.

On June 29, Zeb bought a credit card verification machine/reader for use in the convenience store from Credit Equipment Co. on credit for \$2,500. The parties executed a security agreement giving Credit Equipment Co. a security interest in the machine. On June 30, Credit Equipment Co. filed a financing statement with the Texas Secretary of State. The machine was installed in July. The machine and its metal conduit were bolted onto a built-in counter but were readily removable by unscrewing the bolts.

On July 10, Zeb bought fluorescent lighting appliances from Light Co. on credit for \$1,900. The parties executed a security agreement giving Light Co. a security interest in the appliances. The appliances were installed later on July 14. On July 20, Light Co. filed a financing statement with the Texas Secretary of State.

On July 15, Finance Co. obtained a judgment against Zeb for an unpaid loan. On August 20, Finance Co. properly recorded an abstract of the judgment in the real property records of Dallas County, Texas.

Which of the following creditors has the superior security interest under the Texas UCC as between:

- 1. Bank and Gypsum Co. with respect to the wallboard? Explain Fully.**
- 2. Bank and A-One Plumbing with respect to the two sinks and two commodes? Explain Fully.**
- 3. Bank and Credit Equipment Co. with respect to the credit card verification reader/machine? Explain fully.**
- 4. Finance Co. and Light Co. with respect to the fluorescent lighting appliances? Explain fully.**

Question 5 – Uniform Commercial Code.

Most examinees correctly answered that Bank's interest was superior to Gypsum Co.'s; however, they did not recognize that the wallboard was a building material that became incorporated into the building, and no security interest in them exists. Likewise, most examinees correctly stated that Bank's interest was superior to A-One with respect to the sinks and commodes but failed to recognize that the goods were installed prior to perfection, which was one of the reasons that could preclude its interest from being superior to Bank's construction mortgage. Some also failed to discuss the possibility that the sinks and commodes may not be considered to be readily removable.

Many examinees failed to recognize that the security interest in the credit card machine was perfected prior to installation and that this would be an important fact if the goods were considered to be fixtures.

A few examinees did not carefully read the subpart 4 question and compared Light Co.'s interest with that of Bank instead of comparing Light Co.'s interest with that of Finance Co.

QUESTION 6

Alfred hired Robert to prepare and file his tax returns. On March 3, in exchange for Robert's services, Alfred executed three undated promissory notes – Note A, Note B, and Note C – each in the amount of \$500. Each note was payable to the order of Robert and had a due date of May 30.

On April 1, Robert indorsed all three notes making them payable to Carl as payment for Carl's having painted Robert's house.

Robert failed to timely file or to obtain an extension for filing Alfred's tax return. Robert filed the return on April 20, causing Alfred to incur a penalty of \$300. On April 30, Carl learned of Robert's late filing and the \$300 penalty incurred by Alfred when he overheard an angry conversation between them.

Note A: On June 1, Carl presented Note A to Alfred and demanded payment. Alfred refused to pay.

Note B: On April 25, Carl indorsed Note B making it payable to his daughter, Linda, and gave it to her as a gift. On May 30, Linda presented Note B to Alfred and demanded payment. Alfred refused to pay.

Note C: Also on April 25, Carl indorsed Note C making it payable to his son, Dave, and gave it to him as a gift. On June 2, Dave indorsed Note C making it payable to Barbara in exchange for a pearl necklace he had bought for his wife.

Prior to accepting Note C from Dave, Barbara had learned about Robert's failure to file Alfred's tax return on time and the \$300 penalty.

What liability, if any, does Alfred have on each of the three notes? Explain fully.

Question 6 – Uniform Commercial Code.

Some examinees merely assumed that the notes were negotiable and/or that the holders were holders in due course without discussing the elements of negotiability and the elements required to be a holder in due course. Some examinees failed to recognize that the shelter rule applied to the holder of Note B. Others recognized that the shelter rule applied to make Linda a holder in due course for Note B but did not recognize that the shelter rule also applied to the holders of Note C.

Another common error was the failure to note and discuss the fact that Barbara took Note C with notice that it was overdue.

July 2004

QUESTION 7

Owner owned Graphics, Inc. Joe Jones was Graphics' general manager and had authority to purchase supplies and sign documents necessary to bind Graphics. Both Owner and Joe had authority to sign checks on Graphics' account at Bank.

On May 3, Joe purchased 25 cases of duplicating paper from Supply Co. In payment, Joe signed and delivered a promissory note for \$500 payable to the order of Supply Co. The note was due on May 30 and was signed simply "Joe Jones." Supply Co. knew Joe was Graphics' general manager and understood that Graphics was the party that would pay the note.

On May 6, Joe opened the shipment of paper from Supply Co. and found that the paper was water stained and not suitable for use as duplicating paper. In that condition, it had scrap value of only \$100. Supply Co. was unaware of the water damage.

At noon on May 6, while having lunch with Karl, an officer of Bank, Joe described to Karl the problem with the duplicating paper and told Karl he had given Supply Co. a \$500 promissory note that he was now going to have to rescind.

At 1:00 p.m. on May 6, Supply Co. met with Eli, another officer of Bank, endorsed the note, and sold it to Bank for \$350.

On May 10, Joe paid Graphics' utility bill by sending to Utility Co. a Graphics company check for \$240 drawn on Graphics' checking account at Bank. Joe signed the check simply "Joe Jones." At the time, there was enough money on deposit to cover the check.

On May 11, Owner, without Joe's knowledge, withdrew all the funds from the checking account at Bank and used them to pay creditors. On May 12, Utility Co. presented the \$240 check to Bank for payment, and it was dishonored because there were insufficient funds in the account.

Graphics is now insolvent and out of business.

- 1. What effect, if any, does Joe's having told bank officer Karl about the problem with the shipment of paper have on Bank's right to recover against Graphics on the note? Explain fully.**
- 2. What liability, if any, does Joe have to Bank on the promissory note? Explain fully.**
- 3. What liability, if any, does Joe have on the check to Utility Co.? Explain fully.**

Question 7 - UCC

Among the less successful answers, many examinees discussed the transactions' effects on SupplyCo rather than on Graphics and Joe. The following problems were also common:

Sub-question 1,

Insufficient or no discussion as to negotiability of the note

Apparent confusion about the Bank's role in the transactions, e.g. many viewed it as a depository and discussed check stop payment requirements in relation to whether the Bank had notice that would preclude its being a holder in due course.

With respect to the notice issue, failure to discuss the element of reasonableness of the opportunity to act

Sub-question 2

Insufficient or no discussion as to whether Joe's liability to Bank depended upon whether Bank was a holder in due course.

Many concluded in answer to sub-question 1 that Bank was a holder in due course but inconsistently referred to Bank as not being a holder in due course in answer to sub-question 2, or vice-versa.

Sub-question 3

Many did not seem to recognize the check exception to the general rule regarding signatures by agents.

QUESTION 8

On May 1, Warren started a business as a sole proprietor and leased a \$5,000 computer system from Leasco. The written lease, which was the only document generated in the transaction, provided for monthly payments for five years, with the right to purchase the system at the end of the term for \$1.00.

On June 1, Warren borrowed \$10,000 from Bank, with the understanding that \$3,000 of the loan proceeds were to be used to purchase telephone equipment and \$7,000 were to be used for working capital. Warren signed a promissory note to Bank payable on December 1. To secure the note, Warren executed a security agreement giving Bank a security interest in all of his office equipment now owned or thereafter acquired. Bank promptly perfected its security interest by filing a financing statement on June 3.

On June 2, Warren purchased and installed the telephone equipment.

On November 30, Warren purchased business video equipment for \$2,000 on credit from A-1 Video Co. ("A-1") and signed a promissory note payable to A-1 in twelve monthly installments. Warren executed a security agreement giving A-1 a security interest in the video equipment to secure the installment payments and took possession of the equipment on November 30.

Warren was unable to pay the Bank note when it became due on December 1. On December 5, Warren persuaded Bank to extend the note's payment for thirty days. To induce the Bank to do so, Warren gave Bank a stock certificate he owned for 100 shares of Dotcom Computer as additional collateral. Bank took immediate possession of the certificate.

On December 12, Warren filed a petition in bankruptcy for liquidation under Chapter 7 of the Bankruptcy Code.

On December 13, having learned of Warren's bankruptcy filing, A-1 quickly filed a financing statement with the intent of perfecting its security interest in the video equipment.

Which party among Leasco, Bank, A-1, and the Bankruptcy Trustee has the superior interest in the

- 1. Computer system? Explain fully.**
- 2. Telephone equipment? Explain fully.**
- 3. Video equipment? Explain fully.**
- 4. 100 shares of Dotcom stock? Explain fully.**

Question 8 - UCC

Some answered that the filing of the bankruptcy case trumped everyone's interest.

Many who answered (in sub-question 1) that the Bank had superior interest did not discuss that the purported lease was actually a sale or the reasons why it should be considered a sale. Others just presumed that leases were covered by Article 9. A few concluded that this was a lease and that Lease Co had the superior interest.

Most examinees did well on sub-question 2. Some examinees took the position that the bankruptcy trustee had a superior interest over all the secured creditors.

As to sub-question 3, many answered that A-1 video had the superior interest but failed to address the intervening bankruptcy filing. Some recognized A-1 video as a purchase-money-security-interest lender but concluded that the intervening bankruptcy filing cut off the right to perfect.

Many examinees seemed to have difficulty with sub-question 4. Many did not appear to recognize the preference issue. Some who answered that the bankruptcy trustee had the superior interest based their answer upon an incorrect reason or simply failed to state a reason.

QUESTION 11

Note A: On July 1, 2003, Bob, a resident of Dallas, Texas, purchased telephone equipment from SwitchCo for use in his business. He paid for the equipment by executing and delivering to SwitchCo a negotiable promissory note, Note A. This note was payable to the order of SwitchCo in the principal amount of \$2,000 with interest at the rate of 6% per annum. The note was payable in 12 monthly installments of interest only due on the first of each month, with the principal and any accrued interest payable in full on July 1, 2004. Bob failed to make the March and April 2004 interest payments.

On May 1, 2004, SwitchCo sold Note A to Bank for \$1,200 and told Bank that the March and April interest installments were past due. Bank notified Bob of its acquisition of Note A and directed him to make the interest payments to Bank.

Also on May 1, 2004, the telephone equipment Bob had purchased ceased operating because of a design flaw, and Bob has not been able to get SwitchCo to remedy the flaw. Bob has not made any interest payments since February 1, 2004.

On July 1, 2004, Bank presented Note A to Bob, who refused to pay.

Note B: In October 2003, Bob purchased a deluxe riding lawnmower from Mac's Hardware for use in mowing the lawn at his family residence. He also intended to use it occasionally to mow the lawn in front of the office building he owned and where he operated his business.

Bob paid for the lawnmower by executing and delivering to Mac's Hardware a negotiable promissory note, Note B. This note was in the amount of \$1,500, payable on February 1, 2004. Note B, which was the only documentation reflecting the transaction, did not contain any language to the effect that the note was subject to all claims and defenses which the consumer/debtor could assert against the seller of the goods.

Later in October, the lawnmower ceased operating because the transmission failed. Mac's Hardware promised to get the parts necessary to repair it but never did.

In November 2003, Mac's Hardware needed cash for operating capital. Mac's took what for it was the unusual step of making a bulk sale to LiquidationCo of all the promissory notes Mac's Hardware had taken from its customers in payment for goods sold. This bulk sale included Bob's Note B. LiquidationCo knew at the time it bought the notes from Mac's Hardware that the majority of Mac's business came from financing sales of goods to individual homeowners for home/family use. LiquidationCo did not know of the problem with Bob's lawnmower at the time it acquired Note B.

On February 1, 2004, LiquidationCo presented Note B to Bob for payment. Bob refused to pay.

- 1. Can Bank enforce Note A against Bob? Explain fully.**
- 2. On what grounds can Bob defend his refusal to pay Note B, and what is the likely outcome on each ground? Explain fully.**

Question 11 - UCC

General Comments: Holder in due course was an issue in both parts of the question. Most examinees were able to list and discuss the HDC elements; however, a substantial number did not list or discuss the good faith element. Often the HDC elements were recited as “A holder who takes for value, in good faith, without notice...” but failed to specify without notice of what.

Subpart 1: Many examinees did not discuss the notice to the Bank of the past due interest payments. Of those who did discuss it, some did not recognize that the past due interest did not make the note overdue so as to destroy the Bank’s holder in due course status. Others seemed confused as to what HDC means because they concluded that a holder who is not a holder in due course could not enforce the note at all.

Subpart 2: Few examinees recognized that the FTC notice should have been on the note. Many who did discuss its absence determined that its omission was irrelevant or that because it was missing, the consumer lost his defenses to the note.

QUESTION 12

In July 2003, Walter, while a resident of Ardmore, Oklahoma, borrowed \$15,000 from Bank, located in Dallas, Texas. He borrowed the money to pay off suppliers of his refrigerator repair business in Ardmore. He signed a promissory note for the \$15,000 and a security agreement giving Bank a security interest in a savings deposit account Walter maintained at Bank in Dallas, Texas. Bank did not file any documentation regarding this security interest either centrally or locally.

In August 2003, Walter borrowed an additional \$5,000 from Bank. He signed a promissory note for the \$5,000 and a security agreement giving Bank a security interest in all equipment now owned or hereafter acquired. Bank properly perfected this security interest by filing a financing statement centrally in Oklahoma. At that time Walter owned a pneumatic paint sprayer that he used in his business.

In January 2004, Walter moved to Dallas, Texas and relocated his refrigerator repair business and equipment there. On March 2, 2004, Walter borrowed \$10,000 from FinanceCo for operating capital. He signed a promissory note for the \$10,000 and a security agreement giving FinanceCo a security interest in all his equipment and in the same savings deposit account maintained at Bank in Dallas, Texas. FinanceCo filed the security agreement with the Texas Secretary of State on March 3, 2004. On June 1, 2004 Walter purchased a hydraulic hoist for use in his business.

It is now January 2005 and Walter has defaulted on both loans, and both Bank and FinanceCo claim a superior security interest in the savings deposit account, the paint sprayer and the hydraulic hoist.

Which creditor has the superior security interest in the following:

- a. the savings deposit account?**
- b. the paint sprayer?**
- c. the hydraulic hoist?**

Explain fully as to each.

Question 12 - UCC

Subpart a: A common mistake was concluding that FinanceCo had the superior interest because perfection by filing was required and further concluding that Bank was unperfected. Few discussed which jurisdiction's law governs a security interest in deposit accounts and how it is perfected.

Subpart b: Most recognized that the Bank had attached and perfected its interest in Oklahoma before Finance co. filed and perfected in Texas but some erroneously concluded that the move to Texas to Texas had no effect because perfection was good for five years. This line of answers failed to recognize that perfection remains in effect for four months after the debtor moves his residence and then lapses.

Subpart c: Many missed noting and discussing the fact that FinanceCo did not have an after acquired property clause in its security agreement. It was common for others to conclude FinanceCo had a superior interest in the hydraulic hoist because Bank had an unperfected security interest due to the lapse of Bank's perfection. Some examinees answered Subparts b and c together as if both pieces of equipment were the same and, depending on their answer, only answered Subpart b or Subpart c instead of breaking out the facts separately and a separate result for each piece of collateral.

July 2005

QUESTION 3

In January 1999, John's son, Sam, took Carl's automobile without Carl's permission and, while driving it, caused \$500 in damage to the automobile. Carl claimed the damage to the car was in the amount of \$800 and demanded that John pay him \$800 for these damages. John refused to pay it. Carl threatened to have Sam prosecuted for theft unless John paid. Because of the threat, John signed and delivered to Carl the following promissory note:

February 1, 1999

I promise to pay to the order of Carl out of my savings State Bank account number 20045, at any time within one year of the date of this note, \$800 with interest at the discount rate set by the Federal Reserve in effect at the time of payment. If I pay this note within nine months of its date, no interest shall be due.

/s/ John

On May 1, 1999, Carl indorsed the promissory note and sold it to Anna for \$700 cash. Anna was unaware of the circumstances surrounding the making of the note.

Anna forgot about the note until June 1, 2005, when she made demand upon John for payment. John refused to pay. On July 1, 2005, Anna filed a suit against John to recover on the note.

John asserts the following defenses: (a) Anna cannot enforce the note because Carl misrepresented the amount of damages to the automobile; (b) the applicable statute of limitation bars enforcement of the note; and (c) the note was void from the time of its making because it was executed under duress.

- 1. Was the note signed and delivered by John a negotiable instrument? Explain fully.**
- 2. Do John's three defenses have merit? Explain fully as to each.**

Question 3 – U.C.C.

Negotiability was an issue and most examinees discussed it. Common errors regarding this issue were listing consideration and interest as requirements for negotiability. Many failed to discuss how the elements of the note regarding payment from a specific account, tying the interest rate to the Federal Reserve, options regarding whether interest need be paid at all, and the time of payment, affected its negotiability.

Some examinees decided that the note was not negotiable and then inconsistently determined that the subsequent purchaser of the note was a holder in due course. Many examinees omitted listing good faith as an element of holder in due course status. Some listed taking the note “without notice” but never said without notice of what.

The fraud or misrepresentation element in the facts, the representation of the amount of damages to the car, was often erroneously judged to be a real defense against a holder in due course. The duress issue was discussed by most examinees, but often the discussion never came to a conclusion as to whether under these facts it was available as defense against a holder in due course.

Too many examinees never even discussed the statute of limitations issue. Of those who did, few knew it was six years and many thought there was no statute of limitations on a note or that it would not apply to a holder in due course. Some even confused it with the statute of frauds.

QUESTION 4

On July 1, 2004, Ralph bought on credit and took delivery of a \$5,000 pool table from Tex-Pool for personal use in his family home in Austin, Texas. At the same time, Ralph signed a security agreement giving Tex-Pool a security interest in the pool table to secure the debt. Tex-Pool did not file a financing statement or the security agreement.

On July 4, 2004, Ralph bought on credit from BigBox and took delivery of a new \$900 television for personal use at his home and a new \$3,000 computer system for use in his computer consulting business in Austin, Texas. At the same time, Ralph signed a security agreement giving BigBox a security interest in the television and computer system to secure the debt.

On July 21, 2004, Ralph sold the television and computer system to Harold in exchange for cancellation of a \$4,000 debt Ralph owed Harold. Harold installed the television and computer system in his home for personal use. Harold was unaware of any security interest that Big Box claimed in these items.

On July 22, 2004, BigBox filed a proper financing statement with the Texas Secretary of State listing the television and computer system.

On July 24, 2004, Quincy bought the pool table from Ralph for \$2,500 cash. Quincy installed it in his Bar & Grill for use by his customers. Quincy was unaware of Tex-Pool's security interest.

Ralph has now defaulted on his obligations to Tex-Pool and BigBox.

- 1. As between Tex-Pool and Quincy, which one has the superior right to the pool table? Explain fully.**
- 2. As between, BigBox and Harold, which one has the superior right to:**
 - (a) The television? Explain fully.**
 - (b) The computer system? Explain fully.**

Question 4 – U.C.C.

As to the pool table, a great number of examinees did not recognize that it was a consumer purchase and that perfection was automatic, no filing required. Often examinees misread the facts, stating that Quincy purchased the pool table for personal use, that he didn't use it in his business, or that it didn't matter. Many did not recognize the consumer to consumer sale as an exception to a previously perfected security interest.

Many examinees attempted a joint answer to part 2.a and 2.b. erroneously treating both the TV and the computer system alike. Even where the TV and computer system were analyzed differently, the joint answer format often made it difficult to determine what elements of the answer applied to which item of collateral.

A common error was the failure to differentiate the collateral, in that one item was originally a consumer purchase and the other wasn't. A number of examinees mistakenly relied upon the buyer in the ordinary course of business as a reason to support their conclusions.

QUESTION 3

Trixy White sold Rudolph Red a pair of earrings for five dollars. Rudolph gave Trixy a check for \$5.00 drawn on his account at State Bank as payment for the earrings. Rudolph filled in the body of the check, leaving spaces after the numbers \$5.00 and a large blank space after the word “five,” and signed the check as follows:

“Pay to the order of Trixy White \$ 5.00
five dollars”
Rudolph Red

Trixy altered the amount shown on the check so that it read:

“Pay to the order of Trixy White \$ 500.00
five hundred and 00/100 dollars”
Rudolph Red

Trixy indorsed the check and cashed it at Green Grocery. Green Grocery indorsed the check and deposited it in its account at Ace Credit Union (“Ace”), which credited Green Grocery’s account with \$500. Ace presented the check to State Bank. State Bank paid the check and charged \$500 to Rudolph’s account. When Rudolph received his bank statement, he promptly complained, telling State Bank that the check was only written for \$5.00 and demanding that State Bank re-credit his account with \$495.

Under the U.C.C. as found in the Texas Business and Commerce Code, what are the rights and obligations of the following on the check? Explain each fully.

- 1. Rudolph?**
- 2. Ace Credit Union?**
- 3. Green Grocery?**
- 4. State Bank?**

Question 3 - UCC

Most examinees answered that if the maker of the check's negligence contributed to the alteration it might cause the maker to be liable for the full amount of the altered check but many failed to either recognize or discuss the liability of the maker in the event no negligence was found, i.e. the alteration would discharge the maker and that the bank would be able to enforce the check according to its original terms (\$5.00).

Many examinees did not recognize and discuss the transfer and presentment warranty issues. Numerous answers discussed holder in due course elements as a basis for erroneously concluding that HDC status extinguished any warranty liability. Almost none of the answers that did discuss HDC status recognized that it would entitle the party to enforce the check according to its original terms.

QUESTION 4

Elmer started up a retail computer store business as a sole proprietorship to sell computers to the general public. On January 13, 2005 he borrowed \$20,000 from Bank to purchase inventory and use as working capital. At the same time, he signed a security agreement giving Bank a security interest in “all of the business’ inventory, equipment, accounts, and all other property now owned or hereafter acquired.” On the same day, Bank filed a financing statement with the Texas Secretary of State stating Elmer’s and Bank’s names and mailing addresses and indicating that it had a security interest in “all of Elmer’s assets.” On January 15, 2005, Elmer used the loan proceeds to purchase eight computers for resale and a credit card authenticating machine for use in processing his sales.

On March 1, 2005, Iona, knowing of Bank’s security interest in the computers, purchased four of the computers from Elmer.

On April 1, 2005, Elmer purchased five additional computers on credit from Manufacturer, for which he signed a promissory note for \$5,000 and security agreement Manufacturer giving Manufacturer a security interest in the five computers. Manufacturer filed a financing statement with the Texas Secretary of State stating Elmer’s and Manufacturer’s names and addresses and properly describing the collateral as the five computers but did not otherwise notify anyone.

On May 1, 2005, Harry, who was unaware of any of these security interests, purchased from Elmer the credit card authenticating machine and three of the computers Elmer had acquired from Manufacturer.

On June 1, 2005, Elmer closed his business and left town for parts unknown. He did not pay Bank or Manufacturer any of the amounts owed to them and left the remaining unsold computers (four of the ones he had originally purchased and two of the ones he had later purchased from Manufacturer) on the business premises.

Bank claims that it is entitled, as against all others, to take possession of all the items of property described above.

What rights, if any, does Bank have in:

- 1. The four remaining unsold computers that Elmer had originally purchased? Explain fully.**
- 2. The two remaining unsold computers that Elmer had later purchased from Manufacturer? Explain fully.**
- 3. The four computers purchased by Iona? Explain fully.**
- 4. The three computers and the credit card authenticating machine purchased by Harry? Explain fully.**

Question 4 - UCC

Most examinees understood that the Bank had a security interest in the four remaining computers and many recognized this to be a purchase money security interest. However, many did not discuss the sufficiency of the description of the collateral in the Bank's security agreement and financing statement.

While the majority of the answers recognized that Manufacturer had a purchase money security interest in the two remaining computers purchased from Manufacturer, scores of answers were not aware of Manufacturer's obligation to notify the Bank.

A majority of the examinees recognized the buyer in the ordinary course of business status as applied to buyers Iona and Harry but a substantial number incorrectly assumed that it only applied to Harry because he did not have knowledge of the Bank's security interest whereas Iona did. Some examinees confused the buyer in the ordinary course of business status with a BFP. Many did not distinguish between the computers (inventory) bought by Harry and the credit card authenticating machine (equipment).

QUESTION 5

On January 9, 2006, John dated a check “1/9/06” for \$100 drawn on the State Bank and gave it to Carl as a birthday present. Because John wanted to make sure that only Carl got the money, John crossed out the words “to the order of” on the preprinted check so that the check read “Pay to the order of Carl”. The check was signed by John and otherwise normal in all respects.

Carl wanted to build his body strength and reduce his waistline. Carl asked Sharon, his wife’s dietary weight loss consultant, for some suggestions. Sharon told Carl that she had bought and used the “Miracle Machine”, a metal-frame exercise device that she used to strengthen her abdominal muscles. Sharon told Carl that, although she was not a physical fitness trainer, she thought the machine might work for him, but that he would have to take his own chances. Sharon offered to sell it for \$100.

On January 10, 2006, Carl agreed to buy the “Miracle Machine” and as payment gave Sharon the check he received from John which Carl restrictively indorsed as follows:

“Pay to the Order of Sharon /s/ Carl.” When Sharon attempted to cash the check on February 15, 2006, at State Bank, it was dishonored because John had closed his account on January 31, 2006.

On February 16, 2006, while Carl was using the “Miracle Machine” the metal frame broke. Carl discovered that the frame was badly rusted and the paint concealed the rust.

On February 17, 2006, Sharon demanded that Carl pay her the \$100 for the purchase price. Carl refused and told Sharon that the “Miracle Machine” did not work because he had been using it religiously for five weeks and had not lost any inches and it was defective because it had broken.

- 1. Is Carl liable to Sharon for the \$100 check? Explain fully.**
- 2. What claims, if any, might Carl assert against Sharon under the UCC? Explain fully.**
- 3. Is John liable to Sharon for payment on the check? Explain fully.**

Question 5 - UCC

Sub-Question Q 1: Is Carl liable to Sharon for the \$100? Many examinees didn't distinguish between Carl's liability as an indorser on the check and his liability on the underlying sales contract and/or completely ignored the indorsement liability issue. Many erroneously based Carl's liability on a breach of a transfer warranty. Many did not recognize that indorser liability is discharged if the check was not presented within 30 days.

Sub-Question Q2: What claims, if any, might Carl have against Sharon under the UCC? Examinees needed to discuss whether express warranties, implied warranties of merchantability and fitness for a particular purpose, or disclaimers would or would not apply to these facts.

Sub-Question Q 3: Is John liable to Sharon for the payment on the check? Examinees needed to recognize that John had liability on the check as the drawer.

QUESTION 6

On January 1, 2005, Bob, a cabinet maker, loaned Tommy \$4,000, and in return Tommy signed a negotiable promissory note ("Tommy's Note") payable to the order of Bob at six percent per annum interest.

On February 1, 2005, Bob borrowed \$1,000 from Wilson. Bob signed a promissory note made payable to the order of Wilson and a security agreement giving Wilson a security interest in Tommy's Note. Wilson did not file anything to perfect this security interest.

On February 12, 2005, Bob borrowed \$10,000 from Little Bank. Bob signed a promissory note made payable to the order of Little Bank and a security agreement giving Little Bank a security interest in all of his current and after acquired inventory, the proceeds thereof, and in Tommy's Note. Little Bank immediately filed a proper financing statement with the Secretary of State to perfect this security interest.

On February 15, 2005, Wilson became concerned and asked Bob if he could take possession of Tommy's Note. Bob gave him Tommy's Note.

On March 1, 2005, Bob borrowed \$5,000 from Big Bank. Bob signed a promissory note made payable to the order of Big Bank and a security agreement giving Big Bank a security interest in all of his accounts receivable. Big Bank immediately filed a proper financing statement with the Secretary of State to perfect this security interest.

On March 1, 2005, Bob began making custom cabinets ordered by Homebuilder using the inventory of wood Bob had on hand. On April 1, 2005, Bob delivered the cabinets and invoiced Homebuilder for \$3,000, which Homebuilder failed to pay Bob.

Bob defaulted on his promissory notes to Wilson, Little Bank and Big Bank.

- 1. Which creditor, Wilson or Little Bank, has the superior security interest in Tommy's promissory note? Explain fully.**
- 2. Which creditor, Little Bank or Big Bank, has the superior security interest in the \$3,000 Homebuilder account receivable? Explain fully.**
- 3. Under the UCC, who has the superior interest in the cabinets Bob delivered to Homebuilder? Explain fully.**

Question 6 - UCC

Sub-Question 1. Which creditor, Wilson or Little Bank, has the superior security interest in Tommy's promissory note? Examinees needed to recognize both possession and filing as methods of perfection. Most examinees either stated Little Bank won because it was first to perfect or that Wilson won because possession was a superior form of perfection. Few recognized that Wilson was temporarily perfected for 20 days without filing or taking possession.

Sub-Question 2. Which creditor, Little Bank or Big Bank, has the superior security interest in the \$3,000 Wally Homebuilder account receivable? Examinees had to recognize that both parties perfected their security interests and know that Little Bank's perfected security interest in inventory attached to the account receivable as a proceed of Bob's inventory and that Little Bank had perfected first. Some examinees only discussed Little Bank's interest and didn't mention Big Bank's interest. In some of the better answers, examinees also discussed the issue that Little Bank's perfection could lapse in 20 days under certain circumstances.

Sub-Question 3. Who has the superior interest in the cabinets under the UCC? Examinees had to recognize that no creditor had a security interest in the cabinets because Homebuilder purchased the cabinets in the ordinary course of business.