

FINAL EXAMINATION  
SECURED TRANSACTIONS  
MR. FLINT

7 pages

PLEASE READ CAREFULLY

ALL ANSWERS ARE TO BE WRITTEN IN THE BLUE BOOKS PROVIDED WITH THIS EXAMINATION.

There are six questions of equal value. The time for completing the examination is three hours.

1. This examination is "open book." You may use your casebook, statutory supplement, and classnotes. Use of calculators is permitted. Assume that all action takes place in a jurisdiction in which the Uniform Commercial Code, the Bankruptcy Code, the Internal Revenue Code, and the Uniform Fraudulent Transfer Act is in effect.
2. Be sure to answer the specific question that is asked. Information supplied relating to some unasked question will not increase your score, consumes your time needed to answer the asked questions, and will lower your score if erroneous.
3. If additional facts are necessary to resolve an issue, specify what additional facts you believe to be necessary and why they are significant. You may not make an assumption that changes or contradicts the stated facts.
4. Quality, not quantity, is desired. Think through and briefly outline your answer before you begin to write.
5. Write legibly. Be sure to formulate your answers in complete sentences and paragraphs with proper grammar. Failure to so do will result in an appropriately lower score.
6. Do not seek an interpretation of language in the questions from anyone. If you sense ambiguity or typographical error, correct the shortcoming by shaping the question in a reasonable way and by recording your editorial corrections in your answer.

Under the Honor Code, when you turn in this examination, you affirm that you have neither given, received, nor obtained aid in connection with this examination, nor have you known of any one so doing. If you cannot make this affirmation, you shall note such fact on your examination and must immediately advise the Dean of the reason therefor.

I.

[16.67%--30 minutes]

Arunah Hubbell sold his butcher-shop business to Peltier, Inc., a Michigan corporation, including a distribution liquor license and a merchant liquor license. The sales agreement valued the licenses at \$43,000. Peltier, Inc., paid the purchase price partly in cash with the remainder represented by a promissory note. To secure the promissory note, Peltier, Inc., signed security agreement granting a security interest in fixtures, furniture, and equipment. The security agreement also provides for the reassignment of the liquor licenses subject to the approval of the Michigan Liquor Control Board. Hubbell filed a financing statement in the appropriate offices only on "all the trade fixtures, furniture, and equipment, including all the after acquired goods and chattels, which replace existing equipment only". The financing statement did not mention the liquor licenses.

Peltier, Inc., then entered into negotiations with Augustine Rivard for the sale of the merchant liquor license. Rivard had actual knowledge of the security interest of Hubbell as evidenced by Rivard's attempt to obtain Hubbell's consent to the transfer. Despite Hubbell's refusal to consent, Rivard bought the merchant liquor license and transferred it to his store.

Peltier, Inc., then transferred the distribution liquor license to Ezekiel Solomon for a promissory note. When Solomon defaulted on his note, Peltier, Inc., stopped paying on its note to Hubbell. Hubbell sued Peltier, Inc., under its contract of sale and Rivard seeking to foreclose on the merchant liquor license held by Rivard under the security agreement with Peltier, Inc.

This lawsuit has been filed in your district court. Rivard has moved for a summary judgment. Your law clerk has discovered a rule of the Michigan Liquor Control Board which states:

"A security agreement between a buyer and a seller of a licensed retail business, or between a debtor and a secured party, shall not include the license or alcoholic liquor."  
As district judge, what is your ruling and its reasoning?

II.

[16.67%--30 minutes]

On July 30, 1990 Cary, Inc., borrowed \$200,000 from Gilmore Bank. To secure this obligation, Cary, Inc., signed a security agreement listing 3,000 shares of AT&T and 1,500 shares of IBM as collateral. Cary, Inc., carried these shares in street name with Andrew MacClannachan & Co., Cary, Inc.'s, broker. Gilmore Bank did

not file the security agreement. Instead, Gilmore Bank wrote to Andrew MacClannachan & Co. on July 30, 1990, and advised that Cary, Inc., had assigned these shares of stock as collateral for the loan. The letter enclosed a copy of the promissory note and the security agreement. A few days later, Andrew MacClannachan & Co. sent a reply, refusing to "hold the securities in trust for anyone other than our client," but offering to assist in a physical transfer of stock certification if that was the desire of Cary, Inc.

In January 1992, James Stilley obtained a judgment in the amount of \$291,359.37 against Cary, Inc. In supplementary proceedings, James Stilley discovered the existence of these publicly listed stocks held by Cary, Inc.'s, broker and began efforts to sell them to satisfy its judgment.

A vice-president of Gilmore Bank has entered your associate's office at Blue Stocking Law Firm, P.C., for advice as to what Gilmore Bank can do, if anything, to protect its interest in the stock. What is your advice and its reasoning?

III.

[16.67%--30 minutes]

On November 11, 1985, Frank Stainer & Associates, a partnership composed of Frank Stainer and Frank Stainer, Jr., purchased a 1986 Chrysler Fifth Avenue by entering a retail installment contract for payment of the purchase price. The contract was assigned to Chlouber Credit Corporation, which perfected a security interest in the vehicle. A provision of the installment contract also granted Chlouber Credit Corporation a security interest in any insurance proceeds of the collateral and required Frank Stainer & Associates to maintain insurance naming Chlouber Credit Corporation as an additional loss-payee. Chlouber Credit Corporation's security interest was perfected and duly noted on the car's certificate of title.

Subsequent to the purchase, Frank Stainer & Associates, purchased insurance coverage from Fannie Kubycek Insurance Co. with both Frank Stainer & Associates and Chlouber Credit Corporation listed as loss-payees. On October 20, 1987, Frank Stainer & Associates terminated the insurance policy with Fannie Kubycek Insurance Co. and obtained coverage under a new policy issued by Svoboda Insurance Co. On the application Chlouber Credit Corporation was not identified and hence was not also named as a loss-payee on the new policy.

On April 13, 1988, the automobile was destroyed by fire. In response to a claim under the policy, Svoboda Insurance Company drew a check to Frank Stainer & Associates in the amount of \$11,666, representing the market value of the car, less the deductible feature of \$100. Before the check was delivered,

however, the insured advised Svoboda Insurance Co. that it wished to retain the vehicle. Instead of drafting a new check, it was agreed that the insurer would deliver the check for \$11,666 and the insured would reimburse the insurer for the vehicle's salvage value of \$1,100. As a consequence, the insurer did not acquire title to the damaged vehicle. It also did not acquire possession of the certificate of title.

The insured thereafter applied the proceeds of the Svoboda Insurance Co. check to its own purposes and defaulted in paying the balance of \$8,962 owed to Chlouber Credit Corporation. Frank Stainer & Associates, as well as all of its individual partners, has since begun bankruptcy proceedings.

A Vice-President of Chlouber Credit Corporation, has entered your associate's office at Grab'Em and Keep'Em, P.C., for advice as to whether Chlouber Credit Corporation can recover any of the moneys due it on account of the purchase price of the car. What is your advice and its reasoning?

IV.

[16.67%--30 minutes]

On May 4, 1990, Nicholas Pelletier purchased a Piper Aircraft in the Bahamas and flew it to Texas. On November 21, 1991, Nicholas Pelletier's corporation, Rivard Inc., obtained a loan from Simon Drouillard in the amount of \$120,000. Before making the loan, Simon Drouillard required that Nicholas Pelletier guaranty the debt and give a security interest in the airplane to secure the guaranty. Simon Drouillard filed a UCC-1 with the Texas Secretary of State on December 9, 1991, and also filed a Federal Aviation Administration security agreement on December 23, 1991, in Fort Worth, Texas.

On November 6, 1991, Nicholas Pelletier's partner, Francois DeL'Oeil, asked Jean Valle to fly the airplane to Bastrop, Texas, for its annual inspection required for an aircraft to qualify for its license and told Jean Valle to do what it takes to get the airplane "up and running" and licensed. Jean Valle took possession on November 6, 1991, and flew the plane to Bastrop. Jean Valle charged a ferrying fee of \$100 and a fee of \$795 for the annual inspection. While conducting the inspection, Jean Valle found several things which rendered the airplane unairworthy and began to make the repairs. Annual inspections normally run between \$600 and \$800.

On January 2, 1991, Francois DeL'Oeil contacted Jean Valle and told him to cease working on the aircraft. At this time, Jean Valle had completed the inspection and was 85 % through with the necessary repairs. Jean Valle then began to charge a \$15 per day storage charge for the airplane stored in Jean Valle's maintenance hanger. Storage costs normally run between \$45 and \$85 per month.

On August 10, 1992, Simon Drouillard filed a petition for execution against Nicholas Pelletier to recover the balance due on the \$120,000 note guaranteed by Nicholas Pelletier. The sheriff seized the airplane on August 10, 1992. On March 10, 1993, Jean Valle intervened in the above lawsuit asserting his repairman's lien. On June 9, 1993, the airplane was sold, netting \$37,500. The parties waived jury trial.

As the district judge, what is your ruling on the disposition of the foreclosure moneys and its reasoning? Note that your law clerk has found a Texas possessory lien statute that states:

"A person who repairs or performs maintenance work on an aircraft has a lien on the aircraft for the amount due under the contract for the repairs or maintenance work or if no amount is specified by contract, the reasonable and usual compensation for the repairs or maintenance work....

"A holder of a lien under this [statute] may retain possession of the aircraft subject to the lien until the amount due is paid....

"[I]f the holder of a lien under this [statute] relinquishes possession of the aircraft before the amount due is paid, the person may retake possession of the aircraft as provided by [UCC 9-503]....

"The holder of a lien under this [statute] may not retake possession of the aircraft from a bona fide purchaser for value who purchases the aircraft without knowledge of the lien before the date the lien is recorded....

"Not later than the 30th day after the date of performance of the last repair or maintenance, a holder of a lien under this [statute] who retains possession of the aircraft shall notify the owner shown on the certificate of registration and each holder of a lien on the aircraft as shown by the records maintained for that purpose by the Federal Aviation Administration Aircraft Registry."

V.

[16.67%--30 minutes]

Jose Maria Villarreal on January 17, 1990, created a custodial account at Cavazos National Bank. Pursuant to the agreement, Cavazos National Bank was to provide safekeeping for securities deposited by Jose Maria Villarreal. Cavazos National Bank was also to buy and sell securities as directed by Jose Maria Villarreal, collect the income therefrom and distribute the same as the owner and the custodian should agree from time to time. The agreement contained no provision that securities deposited in the account were intended to be collateral for monies advanced by Cavazos National Bank to Jose Maria Villarreal and provided that it could be terminated by either party upon written notice to the other

party. Following execution of the agreement, Jose Maria Villarreal agreed that the income from the stocks, bonds and other investments forming the res thereof was to be paid to Cavazos National Bank to reduce Jose Maria Villarreal's liability to Cavazos National Bank. These liabilities in the amount of \$14,000,000 had arisen by direct loans to Jose Maria Villarreal and also as a result of surety agreements executed prior to 1990 in connection with loans made to corporate borrowers. The promissory notes for the direct loans had a provision that "Cavazos National Bank shall have a lien upon and a security interest in all securities and other personal property which Cavazos National Bank may now or hereafter have in its possession or control, in any capacity whatsoever". The surety agreements provided that "Cavazos National Bank shall have a continuing lien upon all monies, stocks, bonds, and all other personal property any time coming into possession of Cavazos National Bank". Cavazos National Bank has never filed any financing statements with respect to these liabilities.

Alfaro State Bank obtained a judgment against Jose Maria Villarreal for \$6,000,000 and had a writ of attachment issued and served on Cavazos National Bank as garnishee. The object of the writ was the custodial account being maintained by the trust department of Cavazos National Bank having a value of \$10,000,000. The writ contained language restraining Cavazos National Bank from delivering any property of Jose Maria Villarreal and from paying any debt of Jose Maria Villarreal. Despite this language Cavazos National Bank sold the securities from the custodial account and applied the proceeds on account of the indebtedness of Jose Maria Villarreal to it.

A Vice-President of Alfaro State Bank, has entered your associate's office at Grab'Em and Keep'Em, P.C., for advice as to whether Alfaro State Bank can recover any of the moneys due it from Cavazos National Bank. What is your advice and its reasoning?

VI.

[16.67%--30 minutes]

In 1986 John Hartt, Inc., established a lending relationship with Carll National Bank. Carll National Bank supplied John Hartt, Inc., with working capital loans, which John Hartt, Inc., secured with inventory and accounts receivable. These loans were also guaranteed by Francis Burpee, president, director, and majority stockholder of John Hartt, Inc.

On May 25, 1989, the parties renewed and consolidated four draw notes into a consolidated note. Concurrent with the execution of the consolidated note, John Hartt, Inc., granted Carll National Bank additional security in the form of a security interest in machinery, equipment, furniture, fixtures, office equipment, raw materials, finished goods, work-in-progress, goods in transit, licenses, distribution rights, patents, copyrights, trade secrets,

cash, and all books, records, and computer software evidencing the property.

At the same time John Hartt, Inc., established a revolving line of credit cash collateral account into which John Hartt, Inc., deposited proceeds it collected from accounts receivable and from which John Hartt, Inc., made payments on the consolidated note.

On February 21, 1990, John Hartt, Inc. filed a voluntary liquidation bankruptcy proceeding. The Bankruptcy Trustee has come into your associate's office at Silk Stocking Law Firm, P.C., seeking your advice on an attempt to recover for the bankruptcy estate the additional security and the payments made to the cash collateral account. What is your advice and its reasoning?

Note that on February 21, 1989, Carll National Bank's collateral was valued at \$363,048 securing an obligation of \$1,300,000. On November 23, 1989, Carll National Bank's collateral was valued at \$143,593 securing an obligation of \$1,101,111. On February 21, 1990, Carll National Bank's collateral was valued at \$70,442, securing an obligation of \$1,034,815.