JULY 2011
ESSAY QUESTIONS 1, 2, AND 3

California Bar Examination

Answer all three questions.
Time allotted: three hours

Your answer should demonstrate your ability to analyze the facts in question, to tell the difference between material and immaterial facts, and to discern the points of law and fact upon which the case turns. Your answer should show that you know and understand the pertinent principles and theories of law, their qualifications and limitations, and their relationships to each other.

Your answer should evidence your ability to apply law to the given facts and to reason in a logical, lawyer-like manner from the premises you adopt to a sound conclusion. Do not merely show that you remember legal principles. Instead, try to demonstrate your proficiency in using and applying them.

If your answer contains only a statement of your conclusions, you will receive little credit. State fully the reasons that support your conclusions, and discuss all points thoroughly.

Your answer should be complete, but you should not volunteer information or discuss legal doctrines which are not pertinent to the solution of the problem.

Unless a question expressly asks you to use California law, you should answer according to legal theories and principles of general application.

Question 1

Vicky operates a successful retail computer sales business out of the garage of her house. Vicky told Dan that she intended to go on vacation some days later. Dan subsequently informed Eric of Vicky's intended vacation and of his plan to take all of her computers while she was away. Eric told Dan that he wanted nothing to do with taking the computers, but that Dan could borrow his pickup truck if Dan needed it to carry the computers away.

While Vicky was scheduled to be away on vacation, Dan borrowed Eric's pickup truck. Late that night, Dan drove the truck over to Vicky's house. When he arrived, he went into the garage by pushing a partially open side door all the way open. Vicky, who had returned home early from her vacation, was awakened by noise in her garage, opened the door connecting the garage to the house, and stepped into the garage. When she saw Dan loading computers into the back of the truck, she stepped between Dan and the truck and yelled, "Stop, thief!"

Dan pushed Vicky out of the way, ran to the truck, and drove off. He immediately went to Fred's house where he told Fred what had happened. In exchange for two of the computers, Fred allowed Dan to hide the truck behind Fred's house.

What crimes, if any, have Dan, Eric, and/or Fred committed? Discuss.

Question 2

Doctor performed surgery on Perry's spine to insert a metal rod designed by Bolton, Inc. (Bolton). Shortly after the surgery, Perry developed severe back pain at the location where the rod was inserted. Within the applicable statute of limitations for a tort action for negligence, Perry sued Doctor in federal district court, alleging that she was negligent in using Bolton's rod for the kind of back condition from which he suffered. Personal jurisdiction, subject matter jurisdiction, and venue were proper.

During a deposition, Perry's attorney asked Doctor to state whether she had performed any other spine surgeries using Bolton's rods and, if so, whether any of those surgeries had resulted in complications. Doctor's attorney objected to the questions on the ground that the information requested had nothing to do with whether Doctor was negligent as to Perry, and Doctor refused to answer. After the attorneys properly met and conferred concerning Doctor's refusal, Perry's attorney filed a motion to compel Doctor to answer the questions.

Shortly after the statute of limitations had run, Perry learned through a newspaper article that Bolton had been sued by several patients who alleged that they suffered severe back pain after Bolton's rod was inserted into their spines during surgery. Perry immediately sought and obtained leave to amend his federal complaint to join and include a claim against Bolton, alleging that it had negligently designed the rod. Bolton immediately filed a motion to dismiss Perry's claim against it on the ground that the statute of limitations had already run.

Perry also learned that Doctor had lost a lawsuit brought by another patient with a back condition like his who had also alleged negligence by Doctor for inserting Bolton's rod into his spine. Perry filed a motion for summary judgment against Doctor on the basis of preclusion.

1. How should the court rule on Perry's motion to compel Doctor to answer? Discuss.

2. How should the court rule on Bolton's motion to dismiss Perry's claim on the ground that the statute of limitations had run? Discuss.

3. How should the court rule on Perry's motion for summary judgment? Discuss.

Question 3

Betty is a physician. One of her patients was an elderly man named Al. Betty treated Al for Alzheimer's disease, but since she believed he was destitute, she never charged him for her services.

One day Al said to Betty, "I want to pay you back for all you have done over the years. If you will care for me for the rest of my life, I will give you my office building. I'm frightened because I have no heirs and you are the only one who cares for me. I need to know now that I can depend on you." Betty doubted that Al owned any office building, but said nothing in response and just completed her examination of Al and gave him some medication.

Two years passed. Al's health worsened and Betty continued to treat him. Betty forgot about Al's statement regarding the office building.

One day Betty learned that Al was indeed the owner of the office building. Betty immediately wrote a note to Al stating, "I accept your offer and promise to provide you with medical services for the rest of your life." Betty signed the note, put it into a stamped envelope addressed to Al, and placed the envelope outside her front door to be picked up by her mail carrier when he arrived to deliver the next day's mail.

Al died in his sleep that night. The mail carrier picked up Betty's letter the following morning and it was delivered to Al's home a day later. The services rendered by Betty to Al over the last two years were worth several thousand dollars; the office building is worth millions of dollars.

Does Betty have an enforceable contract for the transfer of the office building? Discuss.

JULY 2011

California
Bar
Examination

Performance Test A

INSTRUCTIONS AND FILE

IN RE BRENT QUILLEN

FILE

IN RE BRENT QUILLEN

INSTRUCTIONS

1. You will have three hours to complete this session of the examination. This performance test is designed to evaluate your ability to handle a select number of legal authorities in the context of a factual problem involving a client.
2. The problem is set in the fictional State of Columbia, one of the United States.
3. You will have two sets of materials with which to work: a File and a Library.
4. The File contains factual materials about your case. The first document is a memorandum containing the instructions for the tasks you are to complete.
5. The Library contains the legal authorities needed to complete the tasks. The case reports may be real, modified, or written solely for the purpose of this performance test. If the cases appear familiar to you, do not assume that they are precisely the same as you have read before. Read each thoroughly, as if it were new to you. You should assume that cases were decided in the jurisdictions and on the dates shown. In citing cases from the Library, you may use abbreviations and omit page citations.
6. You should concentrate on the materials provided, but you should also bring to bear on the problem your general knowledge of the law. What you have learned in law school and elsewhere provides the general background for analyzing the problem; the File and Library provide the specific materials with which you must work.
7. Although there are no restrictions on how you apportion your time, you should probably allocate at least 90 minutes to reading and organizing before you begin preparing your response.
8. Your response will be graded on its compliance with instructions and on its content, thoroughness, and organization.

PAVLIK, GRIEGO & ZACKLER
Attorneys-at-Law

Interoffice Memorandum

Date: July 26, 2011

To: Applicant

From: Allan Zackler

Subject: In re Brent Quillen

A few years ago, our client Brent Quillen cosigned a promissory note at the request of his brother-in-law. The note was issued by InterCon, Inc., a start-up high-tech company formed by Mr. Quillen's brother-in-law, Mark Phillips, to a venture capital firm called First Franklin Group ("First Franklin") to secure a line of credit for operating expenses.

After struggling through a few years of operation, InterCon, Inc. was overtaken by technological advances, and the market for its goods collapsed. InterCon, Inc. has filed bankruptcy proceedings, and First Franklin has made demand on Mr. Quillen to pay the balance due on the note.

After talking to Mr. Quillen and reviewing the documents he furnished, I believe he may have a defense that he can assert against First Franklin and possibly some rights against his brother-in-law. Mr. Quillen is coming in for a follow-up meeting next Monday, and I need to be prepared at that time to advise him of his rights vis-à-vis First Franklin and Mark Phillips. You will find the questions he wants answered on the last page of the transcript of my interview with him.

Please draft a memorandum analyzing the issues raised by Mr. Quillen's questions. For each question, be sure to state the likely outcome. There is no need for an introductory statement of facts in your memorandum.

Transcript of Interview with Brent Quillen

July 21, 2011

Allan Zackler: Mr. Quillen – Brent – thanks for coming in. I've looked at the letter from First Franklin and the promissory note you sent me after our phone conversation a few days ago. Let's talk about the details of what happened and where things stand. It sounds like just another example of the truism that no good deed goes unpunished.

Brent Quillen: You've got that right. I cosigned a promissory note as a favor to my sister and her husband, Mark Phillips, to help them get started on a business venture and now it appears that the chickens have come home to roost.

Zackler: From what little you've told me so far, I don't think it looks all that bleak, but let's start at the beginning – tell me the facts.

Quillen: Well, back in 2002, Mark perfected a patent on a computer device that made network interconnectivity much smoother, and he wanted to manufacture and market it. He pitched the idea to a number of venture capital groups and ended up getting a commitment from First Franklin Group. They agreed to put up $3,000,000 to get him started.

Zackler: Did First Franklin make an outright loan to Mark Phillips, or what?

Quillen: No, they insisted that he form a corporation and give them half the stock. So, Mark formed InterCon, Inc., issued stock, and assigned half of it to First Franklin.

Zackler: Who owns the other half of the stock?

Quillen: Mark and his wife, my sister Vivian, jointly own about one-quarter, and the rest was issued as stock options to key employees.

Zackler: All right. Describe the loan arrangement for me.

Quillen: First Franklin deposited $3,000,000 in an escrow fund subject to the joint control of First Franklin and InterCon. In other words, subject to certain controls exercised by First Franklin, InterCon, Inc. was allowed to draw down prescribed amounts to be used for operating expenses. The loan was backed up by a $3,000,000 promissory note.

Zackler: Was it just $3,000,000 and no more?

Quillen: It was limited to $3,000,000, but I suppose that if things had gone well First Franklin might have advanced more.

Zackler: I see there's no due date on the note. It appears to be a "demand" note. Was it an unsecured note?

Quillen: Yes, it is a demand note and no, it was secured in two ways. As part of the deal, InterCon, Inc. gave First Franklin a security interest in all its equipment and inventory so that if InterCon, Inc. ever couldn't pay, First Franklin could foreclose on its security interest – in other words, repossess and sell the equipment and inventory. Mark says First Franklin perfected its security interest by filing a Commercial Code financing statement with the Secretary of State.

Zackler: OK, I'll check to see if and when it was filed. You said the note was secured in *two* ways – what's the second way?

Quillen: By my cosigning the note.

Zackler: How did that come about?

Quillen: I got a call from my sister, Vivian, asking me to please help out. Apparently, First Franklin told Mark it would make the loan only if he, Mark, signed it as an individual and if he would get me to cosign. I've been fairly successful in business, and the principals at First Franklin know me and that I have substantial assets. They suggested that Mark ask me to cosign, so I agreed to do it. I figured that First Franklin wouldn't have put up any money if they didn't believe Mark had a good product, so I took a chance. I know how tough it is to start a business, and it was my sister, after all, asking for help.

Zackler: Did you get any compensation for your agreement to cosign? I mean, what did you expect to get out of it?

Quillen: Well, Mark made some vague statements about me getting some stock if, and when, InterCon, Inc. went public, but I wasn't holding my breath. No, I just did it as a favor to Mark and Vivian.

Zackler: I see from the copy of the note that you sent me that you signed on the back. Right?

Quillen: That's right.

Zackler: I see that it's signed on the front, "InterCon, Inc., by Mark Phillips, Chief Executive Officer" and then just below that, "Mark Phillips, an individual." What's your understanding about why Mark signed the note as "an individual?"

Quillen: That's an interesting question. He says he signed it only as a guarantor – that he would have to pay only if InterCon, Inc. couldn't pay. I think Mark has talked to a lawyer because he's using language that he wouldn't normally use.

Zackler: What do you mean?

Quillen: He says he wasn't a "principal maker." He's calling himself an "accommodation party" and says that he did not get any "direct benefit" from signing the note. I don't know what all that means, but it sounds to me as if he's trying to avoid any liability.

Zackler: Well, words like "principal maker" and "accommodation party" have important meanings under the Commercial Code. For example, based on what you've told me so far, InterCon, Inc. is the principal maker because the loan was made to it. You're an accommodation party. All that means is that you signed the note *as a favor* to InterCon, Inc. and your brother-in-law. In relation to you, InterCon, Inc. is an "accommodated party." You're essentially a guarantor – by signing, you agreed to pay if InterCon, Inc. didn't.

Quillen: What's Mark's status?

Zackler: Well, I'm not sure at this point. If he signed as a "maker" with the intention of being principally liable just like InterCon, Inc., then that's his status. It's also possible that he's just like you – that is, that he signed just as a favor to InterCon, Inc., in which case he'd also be an accommodation party.

Quillen: What difference does that make as far as my liability is concerned?

Zackler: If Mark is principally liable as a maker, then you have certain rights of recourse against him. If he's an accommodation party like you, then a different set of rights kick in. I'll spell it out to you after I do some research.

Quillen: OK. I'll be anxious to hear what the answer is.

Zackler: Do you know whether Mark or Vivian actually received for their own account any of the money from the $3,000,000 loan?

Quillen: I don't think so. Mark was pretty honest and scrupulous about making sure that all the money went toward the company's operating expenses. Maybe he got a benefit indirectly by getting a salary, but I don't think he put any of the First Franklin money directly in his own pocket. He did tell me – and I think it's the truth – that he

drew only a small salary from InterCon, Inc. during the start-up period and that he was looking forward to the day when the company was successful and he could get some "real money" out of it.

Zackler: The letter First Franklin sent you makes demand on you for $2,000,000 plus interest. The letter refers to a bankruptcy – that's why they're demanding payment, right?

Quillen: Right. InterCon, Inc. exhausted the First Franklin line of credit. Then, in mid-2007, it went out and borrowed another $2,000,000 from Columbia National Bank. InterCon, Inc. ran through that money pretty fast, and then two months ago filed for bankruptcy. That left First Franklin holding the bag, so they called the note.

Zackler: Wait a minute, slow down. What do you mean First Franklin got left holding the bag? Didn't they have a security interest in InterCon, Inc.'s equipment and inventory that they could foreclose on?

Quillen: Well**,** I *thought* they did, but it seems that Columbia National Bank beat them to the punch somehow. Mark told me that, in order to get the loan from the bank, InterCon, Inc. also had to give the bank a security interest in the equipment and inventory. Anyway, the bank is the party that repossessed the equipment and whatever inventory was left, sold it, and applied the proceeds toward its loan.

Zackler: That could be very important. If First Franklin somehow impaired the collateral, letting Columbia National get it, it might be a partial defense for you. What was the value of the equipment and inventory at that time?

Quillen: I don't know. I think the equipment was valuable, but I have no idea about the inventory. I'm sure it had *some* value, but what put InterCon, Inc. out of business was the obsolescence of the product.

Zackler: All right**.** I'll have my paralegal check the Commercial Code filings in the Secretary of State's Office and the bankruptcy court records to see what we can find out. What was the balance due on the First Franklin note at the time InterCon, Inc. filed bankruptcy?

Quillen: As far as I know, it was the full $3,000,000.

Zackler: Then why is Franklin demanding only $2,000,000 from you?

Quillen: That's because they settled with Mark Phillips. Mark told me they accepted $1,000,000 from him in full satisfaction of his obligation, gave him a release, and said that they were coming after me for the rest.

Zackler: Can Mark afford to pay $1,000,000?

Quillen: There are a couple of sources he can tap. My sister has a trust fund left to her by my parents and his parents are fairly well off, so I'm guessing they will help. You know, it seems to me that, since First Franklin released Mark, it ought to be a release against me as well. Why should they be able to pick and choose who they want their money from and decide to pick on me?

Zackler: It's definitely something we'll look into.

Quillen: I'll tell you this. I don't know if it's possible, but if I have to pay First Franklin, I certainly want to go after Mark for reimbursement.

Zackler: I understand completely. Anything else you can think of?

Quillen: No, not at the moment.

Zackler: OK. Let me summarize. I need to get back to you on four questions: (1) Can you get reimbursement from Mark? (2) For that matter, can Mark get any recovery from you? (3) Does First Franklin's apparent loss of its security interest in the equipment and inventory reduce any obligation you have and, if so, to what extent? And (4) Does First Franklin's release of Mark act as a release of you to any extent?

Quillen: That sounds right.

Zackler: All right. Give me a few days to dig up further information and do the research. Can you come in next Monday at 10 o'clock? By then, I'll have a handle on what your rights and obligations are, and we can talk about them and what to do next.

Quillen: Terrific. I'll see you then. Thanks.

PAVLIK, GRIEGO & ZACKLER
Attorneys-at-Law

Interoffice Memorandum

Date: July 24, 2011

To: Allan Zackler

From: Barnett Graves, Paralegal

Subject: In re Brent Quillen

Mr. Zackler: Here's the information you asked me to research. I'm fairly confident that it's reliable.

1. Commercial Code Filings: For a security interest in a debtor's inventory and equipment to be perfected under the Commercial Code, the secured party must file a financing statement describing the collateral sufficiently to give public notice that the collateral is subject to the creditor's security interest. The filing must be made in the Secretary of State's Office. I searched that office's computerized records of Commercial Code financing statement filings and received a Secretary of State's certification of the following:

- Financing statement filed by First Franklin Group. It is dated March 1, 2002 and filed on March 4, 2002. It documents a security interest granted to First Franklin Group by InterCon, Inc. in a security agreement dated March 1, 2002 and describes the collateral as "All present and hereafter acquired equipment and inventory of InterCon, Inc."
- Financing statement filed by Columbia National Bank. It is dated June 1, 2007 and filed on June 4, 2007. It documents a security interest granted to Columbia National Bank by InterCon, Inc. in a security agreement dated June 1, 2007 and describes the collateral as "All present and hereafter acquired equipment and inventory of InterCon, Inc."

- There are no continuation statements or other filings reflecting any other security interest in property of InterCon, Inc.

2. Search of Bankruptcy Court records in InterCon, Inc. bankruptcy proceedings: You asked me to search the records regarding claims filed by InterCon, Inc.'s creditors in the Bankruptcy Court, especially claims filed by First Franklin Group and Columbia National Bank. Here is what I discovered:

- First Franklin and Columbia National Bank both filed early claims purporting to be secured creditors, each claiming to have a priority claim to InterCon, Inc.'s equipment and inventory.
  - First Franklin's claim was in the amount of $3,000,000, plus interest, "subject to reduction after repossession and sale of its collateral and application of the proceeds of the sale to promissory note."
  - Columbia National's claim was in the amount of $2,000,000 plus interest, "subject to reduction after repossession and sale of its collateral and application of the proceeds of the sale to promissory note."
- In a hearing before the bankruptcy judge, it was determined that Columbia National Bank had priority and that Columbia National Bank was entitled to take possession and sell the collateral. The ground of the ruling was that First Franklin's security interest had "lapsed."
- Columbia National Bank filed an amended claim as an unsecured creditor after sale of the collateral and application of the proceeds to the amount owed it. That claim shows the following:
  - Initial balance of debt: $2,000,000 plus interest.
  - Net proceeds of sale of equipment applied to the balance: $800,000.
  - Net proceeds of sale of inventory applied to the balance: $400,000.
  - Unsecured remaining balance due: $800,000 plus interest.
- First Franklin filed an amended claim as an unsecured creditor showing the following:

- "Balance due on promissory note signed by InterCon, Inc. and Mark Phillips as principals, and indorsed by Brent Quillen in the amount of $3,000,000, plus interest."
- The claim recited that "First Franklin will file a further amended claim after recovery, if any, on the note from cosigner, Mark Phillips, and indorser Brent Quillen."

- An accounting filed by the Bankruptcy Trustee states that "It is very doubtful that there will be any appreciable distribution to unsecured creditors after liquidation of the bankrupt estate and payment of costs of administration."

3. Use of funds from First Franklin loan: You also asked me to see what I could find out about how the First Franklin funds were used and what Mark Phillips's compensation arrangements as CEO of InterCon, Inc. were. The bankruptcy schedules and report of the Bankruptcy Trustee show the following:

- The only compensation arrangement between InterCon and Phillips was that he was to be paid a salary of $1,500 per month and reimbursement for travel and related business expenses.
- It appears that the only other benefit Phillips received is that the company leased him a mid-sized automobile for his personal use. All cash advances from both the First Franklin and Columbia National loans were used for operating expenses, including payment of salaries and wages of employees, except that it appears that Phillips himself drew his salary only in months when there was a positive cash flow.
- Phillips has filed a claim in the bankruptcy for $18,000 in unpaid wages.

Incidentally, I called First Franklin and spoke with Lance Templar, its managing partner. He confirms that First Franklin and Mark Phillips entered into a release and settlement agreement, but he refused to tell me the details.

Please let me know if there is anything further you want me to do.

FIRST FRANKLIN GROUP, LLP
Venture Capital Investors
One Success Way
Mayfield, Columbia 32459

Telephone: (555) 444-4500
Facsimile: (555) 444-3200

July 11, 2011

CERTIFIED MAIL
RETURN RECEIPT REQUESTED

Mr. Brent Quillen
1251 Bellow Lane
Mayfield, Columbia 32466

Dear Mr. Quillen:

The purpose of this letter is to make a presentment and demand upon you for payment of the balance due on the PROMISSORY NOTE (copy attached) that you signed as an indorser. As you know, InterCon, Inc. is insolvent and is currently in Chapter 7 bankruptcy proceedings. InterCon, Inc. is therefore unable to pay the note.

We call upon you in your capacity as indorser to pay forthwith the sum of $2,000,000 plus accumulated interest, which is the balance due on the note. We will make available to you our accounting records in the event you wish to ascertain the history of advances on the note since its inception in 2002.

We look forward to receiving your remittance within the next 30 days. We will, upon receipt of payment, surrender the signed original of the note to you and assign to you all rights we may have against other parties to the note, including our claim in the bankruptcy proceedings.

Very truly yours,

Lance Templar

Lance Templar
Managing Partner

Copy of Front of Promissory Note

[FRONT]

PROMISSORY NOTE

Date: March 1, 2002
Amount: $3,000,000.00

Maker hereby promises to pay First Franklin Group on demand or to its order the sum of $3,000,000.00 or the balance due at the time of demand, plus accumulated interest at the rate of 10% per annum. Advances up to the face amount of this note shall be made upon request of Maker and upon approval of First Franklin Group and shall be repaid periodically from operating revenues of Maker.

This promissory note is secured by a security interest granted by Maker in its equipment and inventory.

Any failure to make a payment on time shall be deemed to be a default, and the entire remaining balance shall thereupon be immediately due and payable and shall thereafter bear interest at the rate of 10% per annum until paid.

In the event it becomes necessary for First Franklin Group or any transferee of this note to take legal action to collect on this promissory note, First Franklin or said transferee shall be entitled to recover costs incurred, including a reasonable attorney's fee.

InterCon, Inc.

By *Mark Phillips*

Mark Phillips, Chief Executive Officer

Mark Phillips

Mark Phillips, an individual

Copy of Back of Promissory Note

[BACK]

Brent Zuillen

Guarantor

JULY 2011

California
Bar
Examination

Performance Test A

LIBRARY

IN RE BRENT QUILLEN

LIBRARY

Walker on Negotiable Instruments

by

Professor Ervin E. Walker, University of Columbia School of Law

This treatise is intended as an introduction to Article 3 of the Columbia Commercial Code (the Code) dealing with negotiable instruments. Its purpose is to familiarize lawyers with the basics of the Code and to help them navigate the often dense statutory language.

* * *

Promissory notes: (a) A promissory note is an instrument given for value in a commercial transaction to support an obligation to pay money, usually connected with the extension of credit by a creditor or a loan by a lender. To be negotiable, the note must be an unconditional promise to pay a fixed sum of money at a certain time or upon demand.

* * *

(c) **Definitions: Signatories – Parties to the note:** Persons or entities on whose creditworthiness a creditor will extend credit or make a loan fall into different categories and incur different rights and obligations depending on the capacity in which they sign the note.

- **Maker or Principal Obligor –** A maker or principal obligor – usually the buyer in a credit transaction or the borrower in a loan transaction – is one who signs the note on its face and is primarily liable to pay it according to its terms.
- **Indorser –** A person or entity who signs the note on the back and who undertakes to pay the note according to its terms if the maker does not.
- **Accommodation Party –** A signer of the note who does not receive a direct benefit from the extension of credit or the loan but who signs as a "favor" to the maker. The following example may help to illustrate: Suppose ABC Corp. seeks a loan from Bank to purchase equipment, supplies and inventory. Bank is willing to make the loan but is not totally confident of ABC's creditworthiness. Bank insists that ABC find a

responsible, creditworthy “cosigner” or “guarantor” to become obligated on the note and to pay it if ABC does not. Suppose ABC induces a third party to “cosign.” That third party, who does not stand to benefit directly from the proceeds of the loan, becomes an “**accommodation party**,” i.e., he or she signed as an accommodation or as a favor to ABC to help ABC obtain the loan.

- An accommodation party can sign on the face of the note, in which case, he or she becomes an **accommodation maker**, or
- That person can sign on the back, in which case he or she becomes an **accommodation indorser.**
- The rights and obligations of an accommodation party differ according to whether he or she signed as a maker or an indorser. Those rights and obligations are spelled out in Article 3 of the Code.

- **Maker (Principal Obligor) v. Accommodation Maker:** As already noted the rights and obligations of a signer differ according to whether he or she is a principal maker or an accommodation party. It is not always easy to tell the difference. Suppose Mr. X signed on the face of a note in the space directly under the signature of the corporation to which a loan has been made. Mr. X can be either a principal obligor or an accommodation maker. The key inquiry is whether and to what extent Mr. X received a direct benefit from the proceeds of the loan. If he did receive a direct benefit, he is probably a maker primarily obligated to pay the note. If not, he is probably an accommodation maker, secondarily obligated to pay the note.
- **Accommodated Party:** An “accommodated party” is the party to whom the credit was extended or the loan was made. That party is “accommodated” in the sense that it was the recipient of the “favor” done by the third party “cosigner” or “guarantor." In the example given above, ABC Corp. is the accommodated party.

Excerpts from Columbia Commercial Code

Section 3415. Obligation of Indorser.

(a) If an instrument is dishonored, an indorser is obliged to pay the amount due on the instrument according to the terms of the instrument at the time it was indorsed. The obligation of the indorser is owed to a person entitled to enforce the instrument or to a subsequent indorser who paid the instrument under this section.

Section 3419. Instruments Signed for Accommodation.

(a) If an instrument is issued for value given for the benefit of a party to the instrument ("accommodat**ed** party") and another party to the instrument ("accommodat**ion** party") signs the instrument for the purpose of incurring liability on the instrument without being a direct beneficiary of the value given for the instrument, the instrument is signed by the accommodation party "for accommodation."

(b) An accommodation party may sign the instrument as maker . . . or indorser and . . . is obliged to pay the instrument in the capacity in which the accommodation party signs. The obligation of an accommodation party may be enforced whether or not the accommodation party receives consideration for the accommodation.

(c) A person signing an instrument is presumed to be an accommodation party . . . if the signature is an anomalous indorsement or is accompanied by words indicating that the signer is acting as surety or guarantor with respect to the obligation of another party to the instrument.

* * *

(e) An accommodation party who pays the instrument is entitled to reimbursement from the accommodated party and is entitled to enforce the instrument against the accommodated party. An accommodated party who pays the instrument has no right of recourse against, and is not entitled to contribution from, an accommodation party.

Section 3604. Discharge by Cancellation or Renunciation.

(a) A person entitled to enforce an instrument, with or without consideration, may discharge the obligation of a party to pay the instrument (i) by an intentional voluntary act such as surrender of the instrument to the party . . . or (ii) by agreeing not to sue or otherwise renouncing rights against the party by a signed writing.

Section 3605. Discharge of Indorsers and Accommodation Parties.

* * *

(b) Discharge, under Section 3604, of the obligation of a party to pay an instrument does not discharge the obligation of an indorser or accommodation party having a right of recourse against the discharged party.

* * *

(e) If the obligation of a party to pay an instrument is secured by an interest in collateral and a person entitled to enforce the instrument impairs the value of the interest in collateral, the obligation of an indorser or accommodation party having a right of recourse against the obligor is discharged to the extent of the impairment. The value of an interest in collateral is impaired to the extent (1) the value of the interest is reduced to an amount less than the amount of the right of recourse of the party asserting discharge, or (2) the reduction in value of the interest causes an increase in the amount by which the amount of the right of recourse exceeds the value of the interest. The burden of proving impairment is on the party asserting discharge.

* * *

(g) Under subdivision (e), impairing value of an interest in collateral includes (1) failure to obtain or maintain perfection or recordation of the interest in collateral, (2) release of collateral without substitution of collateral of equal value, (3) failure to perform a duty to preserve the value of collateral owed to a debtor or surety or other person secondarily liable, or (4) failure to comply with applicable law in disposing of collateral.

Official Comments to Section 3605

Subsection (e) deals with the discharge of sureties (such as accommodation parties) by impairment of collateral. Subsection (g) states common examples of what is meant by impairment. The surety is discharged to the extent the surety proves that impairment was caused by a person entitled to enforce the instrument. For example, suppose the payee of a secured note fails to perfect a security interest. The collateral is owned by the principal debtor who subsequently files in bankruptcy. As a result of the failure to perfect, the security interest is not enforceable in the bankruptcy. If the payee obtains payment from the surety, the surety is subrogated to the payee's security interest in the collateral. In this case, the value of the security interest is impaired completely because the security interest is unenforceable. If the value of the collateral is as much or more than the amount of the note, there is a complete discharge.

Section 9515. Duration and Effectiveness of Financing Statement; Effect of Lapsed Financing Statement.

(a) A filed financing statement is effective for a period of five years after the date of filing.

(b) The effectiveness of a filed financing statement lapses on the expiration of the period of its effectiveness unless before the lapse a continuation statement is filed. Upon lapse, a financing statement ceases to be effective and any security interest that was perfected by the financing statement becomes unperfected. If the security interest becomes unperfected upon lapse, it is deemed never to have been perfected as against a purchaser of the collateral for value.

Venaglia v. Kropinak
(Columbia Court of Appeal, 2005)

The Appellants, Frank Venaglia, Ann P. Venaglia, and Roy J. Venaglia (the Venaglias), sued Roy M. Kropinak on his guarantee of a $68,000 promissory note issued by Downtown Business Center, Inc. (DBC) and payable to the Venaglias. Kropinak was an officer and shareholder of DBC. The trial court granted Kropinak's motion for summary judgment. The Venaglias appeal, asking that we set aside the summary judgment against them. This appeal requires us to examine the capacities in which the parties signed the promissory note and their consequential suretyship rights and obligations under the Columbia Commercial Code (the CCC).[1]

I. BACKGROUND

DBC agreed to purchase a downtown commercial property from the Venaglias for $470,000, with $90,000 due at closing and the balance payable under a real estate contract. As part of the transaction, DBC gave the Venaglias a promissory note in the amount of $68,000. The note was signed "Robert J. Doucette, President of DBC." Immediately beneath Doucette's signature was the inscription "GUARANTOR (individually)," under which was the signature of Kropinak. No collateral secured the note.

DBC eventually failed to make the promised payments on the balance owed, and the Venaglias terminated the contract. At the time of termination, the balance due was $340,000. Shortly afterwards, the Venaglias and DBC entered into a settlement and mutual release agreement, under which DBC relinquished the property to the Venaglias. In addition, although acknowledging that DBC had equity in the property, DBC gave up all rights to recoup any such equity. Ron Perea, then president of DBC, signed the settlement agreement for DBC. Kropinak did not sign the settlement agreement.

[1] Unless otherwise noted, all citations in this opinion are to the Columbia Commercial Code.

Nine days later, the Venaglias sold the property to Suzanne Dutcher for $425,000. If DBC had retained the property and sold it for that amount, it would have been more than enough to pay off all the principal and interest that DBC owed on the property, including the $68,000 note that Kropinak had signed as guarantor.

The Venaglias brought this suit against Kropinak to recover on the $68,000 note. Kropinak filed a motion for summary judgment. The motion for summary judgment focused on the validity of defense raised by Kropinak. The district court granted summary judgment to Kropinak, ruling that his defense was meritorious.

We disagree with that ruling. Kropinak's defenses fail as a matter of law. He asserts a defense under the Columbia Commercial Code to the effect that he is fully discharged from his guarantee because the Settlement Agreement between the Venaglias and DBC prejudiced his rights as a guarantor. The gist of his assertion of prejudice is as follows: Although the Settlement Agreement explicitly states that "DBC acknowledges that it has 'equity' in the [P]roperty," DBC relinquished to the Venaglias all its rights in the Property. This left DBC with no assets whatsoever. Thus, if Kropinak were to pay off the Promissory Note in accordance with his guaranty, he would not be able to obtain any reimbursement from DBC. The unfairness of this result is apparent from the fact that a few days after execution of the Settlement Agreement, the Venaglias entered into a contract to sell the Property for a sum that exceeded what DBC owed on the Real Estate Contract and the Promissory Note. In other words, one could say that DBC's "equity" in the Property prior to the Settlement Agreement (the value of the Property less the amount owed on the Real Estate Contract) exceeded the amount owed on the Promissory Note. Hence, if DBC had obtained full value for its interest in the Property, it could have paid off the note guaranteed by Kropinak.

Kropinak contended that, pursuant to CCC Section 3605(b), he was discharged because the Settlement Agreement destroyed his right of recourse against DBC, whose only asset was its interest in the property.

II. DISCUSSION

The principal source of law governing the rights and duties of the parties with respect to a guarantee of a promissory note is Article 3 of the Columbia Commercial Code. To begin our analysis, we observe that Kropinak is an accommodation party with respect to the Promissory Note. As stated in § 3419(a):

> If an instrument is issued for value given for the benefit of a party to the instrument ("accommodated party") and another party to the instrument ("accommodation party") signs the instrument for the purpose of incurring liability on the instrument without being a direct beneficiary of the value given for the instrument, the instrument is signed by the accommodation party "for accommodation".

Section 3419(c) states in pertinent part:

> A person signing an instrument is presumed to be an accommodation party and there is notice that the instrument is signed for accommodation if the signature . . . is accompanied by words indicating that the signer is acting as surety or guarantor with respect to the obligation of another party to the instrument.

Kropinak meets the definition of § 3419(a) because it is undisputed that Kropinak signed the Promissory Note as a guarantor, that the purpose of the note was to enable DBC (the promisor on the note) to enter into the Real Estate Contract with the Venaglias, and that Kropinak was not a “direct beneficiary” of the transaction. (See § 3419(a).) Also, the presumption of § 3419(c) applies because Kropinak's signature appears under the heading "GUARANTOR (individually)."

We now turn to Kropinak's defense that he was discharged because DBC’s settlement deprived him of his right of recourse.

Kropinak Was Not Discharged Under Section 3605(b).

Section 3605 addresses the discharge of accommodation parties. Subsection (b) states:

> Discharge . . . of the obligation of a party to pay an instrument does not discharge the obligation of an . . . accommodation party having a right of recourse against the discharged party.

Relying on this language, Kropinak argues essentially as follows: That he was an accommodation party and, as such, would have rights of recourse against DBC (the discharged accommodated party); but he has no effective right of recourse because DBC no longer has any assets; its sole asset was an interest in the Property, and DBC relinquished that interest to the Venaglias in the Settlement Agreement. He argues, therefore, the discharge of DBC also discharges Kropinak.

We reject this argument. The second premise in the syllogism is flawed: Kropinak *does* have a right of recourse against DBC. Kropinak fails to distinguish between (a) the right of recourse against a party and (b) the economic value of that right. One can have a right of recourse against a destitute person. The right may not be worth anything, but it exists.

Here, Kropinak has a right of recourse against DBC to the extent that he makes payment on the Promissory Note. This right of recourse is explicitly provided by § 3419(e), which states:

> An accommodation party who pays the instrument is entitled to reimbursement from the accommodated party and is entitled to enforce the instrument against the accommodated party.

Although in some, perhaps most, contexts a "worthless" right should be treated as no right at all, such treatment is inappropriate when dealing with accommodation parties. After all, the *very purpose* of procuring an accommodation party is to have a source of payment if the accommodated party is unable to pay in full. When the accommodated party cannot pay in full, the promisee (here, the Venaglias) should be able to collect everything possible from the accommodated party and then proceed against the accommodation party. Collecting from the accommodated party can often be facilitated by the promisee's release of the accommodated party in return for the accommodated party's paying what it can. In general, the accommodation party should have no complaints about such a settlement agreement between the promisee and the

accommodated party because it knew that the promisee would look to it if the accommodated party encountered financial difficulty. The accommodation party should not be entitled to relief on the ground that the accommodated party has no assets from which the accommodation party can obtain recourse because it is precisely the potential of such financial straits of the accommodated party that created the utility of having the accommodation party guarantee the note. As stated in Official Comment 3 to § 3605(b):

> As a practical matter, Bank [the promisee] will not gratuitously release Borrower [the accommodated party]. Discharge of Borrower normally would be part of a settlement with Borrower if Borrower is insolvent or in financial difficulty. If Borrower is unable to pay all creditors, it may be prudent for Bank to take partial payment, but Borrower will normally insist on a release of the obligation. If Bank takes $3,000 and releases Borrower from the $10,000 debt, Accommodation Party is not injured. To the extent of the payment Accommodation Party's obligation to Bank is reduced. The release of Borrower by Bank does not affect the right of Accommodation Party to obtain reimbursement from Borrower if Accommodation Party pays Bank. Section 3419(e). Subsection (b) is designed to allow a creditor to settle with the principal debtor without risk of losing rights against sureties. Settlement is in the interest of sureties as well as the creditor.

In short, § 3605(b) is not intended to protect an accommodation party from a settlement in which the promisee discharges the accommodated party in return for paying all that it can on the note. The accommodation party should expect to be obligated to pay to the extent that the accommodated party does not have the resources to pay.

III. CONCLUSION

We hold that the district court erred in granting Kropinak summary judgment. We reverse and remand for further proceedings consistent with this opinion.

Melandris v. Richter
(Columbia Supreme Court, 2007)

This suit for declaratory relief reaches us on the cross-appeals of parties to a promissory note. David Richter was the founder, President, and Chief Executive Officer of Pharmacopaea, Inc., a Columbia corporation (the Corporation), a wholesaler of perishable pharmacological products. The Corporation's warehouse was equipped with refrigerated facilities where drugs requiring refrigeration were stored.

In 1995, the Corporation borrowed $500,000 from Merchants and Manufacturers Bank (the Bank). The documentation consisted of a loan agreement, a ten-year interest-only promissory note, and a security agreement granting the Bank a security interest in the Corporation's "inventory." The Bank duly filed a financing statement with the Columbia Secretary of State to perfect its security interest and later filed a valid continuation statement to preserve its interest.

The signatures on the face of the promissory note were as follows: "Pharmacopaea, Inc., By David Richter, Chief Executive Officer," and immediately below that signature, "David Richter." On the back of the note appeared the anomalous indorsement of Martina Melandris, a representative of one of the Corporation's principal suppliers[2].

In early 2005, as the result of a disastrous loss in a product liability suit stemming from the Corporation's supplying faulty drugs to retailers, the Corporation was rendered insolvent and filed bankruptcy. The $500,000 balance on the promissory note became due and payable, and the Corporation's insolvency made it impossible for it to pay the

[2] Columbia Commercial Code § 3205(d) defines "anomalous indorsement" as "an indorsement made by a person who is not a holder of the instrument." Ordinarily, indorsement of a note accompanies *negotiation* of the note – the indorser signs on the back to pass rights in the note from himself as holder to another holder/taker for value. An *anomalous* indorsement is not made for the purpose of negotiating the note, but simply for accommodation purposes of creating "backup" liability. It is "anomalous" in the sense that it is outside the chain of negotiation.

note. The Bank immediately took possession of the Corporation's unsold inventory of drugs then valued at about $300,000. The Bank's representatives responsible for preserving the collateral failed to provide adequate refrigerated facilities for the storage of the drugs pending their sale. As a result, the entire inventory spoiled and became valueless.

The Bank then made demand upon David Richter and Martina Melandris for payment of the note. One of the issues in that litigation, which is still pending unresolved is whether, and to what extent, Richter and Melandris are discharged from any obligation to the Bank by reason of the spoliation of the inventory of drugs. Both of them have defended that action by asserting either partial or complete discharge under Columbia Commercial Code (the code) §§ 3605(e) and (g), which provide for discharge of an indorser or accommodation party "to the extent of the impairment" when the secured creditor who is entitled to enforce the note has "[failed] to perform a duty to preserve the value of the collateral." If the Bank in fact failed to protect the repossessed inventory, then, depending on the capacities in which Richter and Melandris signed the note, there will be a discharge "to the extent of the impairment." The extent of the impairment is not before us, but what is before us is the issue of the capacity in which Richter and Melandris signed the note and the consequences that flow therefrom.

Melandris indisputably signed the note as an accommodation party. She asserts that she signed as an accommodation both to the Corporation, which was a significant customer, and Richter, its CEO. None of the proceeds of the Bank's loan inured to Melandris's direct benefit. In this case, she seeks a declaration that (i) Richter is a non-accommodation maker of the note (i.e., that he was an accommodated party) and (ii) that, if she is required to pay the Bank, she is entitled to full reimbursement from Richter. Richter's position is more complicated. He seeks a declaration (i) that he signed the note as an accommodation maker and (ii) that, in any event, irrespective of whether it is ultimately determined that he is an accommodation maker or a non-accommodation maker, he is entitled to contribution (i.e., a recovery of one-half of

whatever he pays) from Melandris for any payment he may be required to make to the Bank.

Let us first examine Melandris's contentions. In support of her position that Richter was an accommodated party and therefore principally liable on the note (i.e., that he was not a surety), she points to § 3419(c), which states that "A person signing an instrument is presumed to be an accommodation party . . . if the signature is . . . accompanied by words that the signer is acting as a surety or guarantor with respect to the obligation of another party to the instrument." By inverse reasoning she argues that, since Richter's signature on the face of this note is *unaccompanied* by such words, the presumption works the other way and that he is necessarily an accommodated party principally liable on the note and not a surety.

She then cites § 3419(e) of the Code, which provides that "An accommodation party who pays the instrument is entitled to reimbursement from the accommodated party . . . . An accommodated party who pays the instrument has no right of recourse against, and is not entitled to contribution from, an accommodation party." Thus, if Melandris's position is correct – that Richter is an accommodated party – and if she pays the note, she would be entitled to get full reimbursement from him.

However, we do not believe the solution to Richter's status is as simple as Melandris would have it. Her inverse reading of § 3419(c) (*supra*) is flawed. The presumption that Richter would be an accommodation party if he had signed as a "surety or guarantor" is not rebutted merely by showing that he did *not* so sign. He can still be an accommodation party even absent such accompanying words. Nor is it determinative of Richter's status that he signed the note on the face as a maker. (Section 3419(b) provides that "An accommodation party may sign the instrument as maker . . . or indorser . . . .")

We now turn to Richter's contentions. The initial inquiry into whether Richter is an accommodated party or an accommodation party turns on the statutory definitions.

Section 3419(a) provides as follows:

> If an instrument is issued for value given for the benefit of a party to the instrument ("accommodated party") and another party to the instrument ("accommodation party") signs the instrument for the purpose of incurring liability on the instrument *without being a direct beneficiary of the value given* for the instrument, the instrument is signed by the accommodation party for accommodation.

Richter relies on the italicized language of the foregoing quotation and asserts that he is an accommodation party because he received no direct benefit from the Bank's loan. In support of that argument, he contends that as one who cosigned a note that was given for a loan to Corporation, he is an accommodation party if no part of the loan was paid to him or for his direct benefit. This, he contends, is true even though he might have received an indirect benefit from the loan because he was employed by the corporation. We do not believe the matter is so simple. Although it is a question of first impression for this court, a court in our sister state of Olympia has had an opportunity to address this point. In *First National Bank v. Rafoth*, the Olympia Supreme Court identified five factors for determining whether one who signed as a maker was or was not an accommodation party:

(i) Corporate capacity/ownership of the signer;

(ii) Location of the signature on the note (i.e., on the face, where a non-surety maker would ordinarily sign, or on the back, where an anomalous indorser would sign);

(iii) The language used in conjunction with the signature;

(iv) Whether the signer received the loan proceeds; and

(v) Intent of the parties.

We are persuaded by the Olympia case that the inquiry goes beyond simply whether the signer directly received the loan proceeds and that the result depends on application of the facts to the enumerated factors. On the record before us, we are unable to make a determination because there is a dearth of facts. The parties relied below on purely legal arguments and did not present the surrounding facts to flesh out the arguments sufficiently. Of the five factors articulated above, the only factors that

we are able to answer based on the facts we have are (i) – that Richter was President and CEO of Pharmacopaea, Inc., (ii) – that he signed on the face of the note as a maker, and (iii) – that he signed his name unaccompanied by a modifying adjective. The remaining factors, (iv) and (v), are likely to be the more influential ones and as to those, we have no clue. Accordingly, we cannot resolve this dispute definitively without further evidentiary proceedings below. We can, however, answer to some extent the contentions of the parties as follows.

As noted, Melandris is unquestionably an accommodation party and therefore obligated to the Bank for the balance due on the note, whatever that balance might be after offset, if any, for impairment of collateral. The ultimate resolution of the dispute presented to us for declaratory relief will turn on whether Richter is an accommodated party (i.e., a non-accommodation maker principally liable on the note) or an accommodation party (i.e., a surety). If he is an accommodated party and Melandris pays any or all of the note, then Melandris as an accommodation party is entitled to full reimbursement from Richter of whatever sum she pays. Richter would not be entitled to contribution from Melandris. (See § 3419(e), *supra*.)

On the other hand, if Richter were ultimately found to be an accommodation party, he also would be independently liable to the Bank for balance due on the note. In that event, Melandris would have no right of recourse – neither reimbursement nor contribution – against Richter.

This follows from the fact that, under the Code, the liability of accommodation parties to an instrument is *separate* and several, not joint and several. The Code makes provision for contribution only among parties jointly and severally liable on an instrument, but not otherwise. Thus, if *both* Melandris and Richter are accommodation parties, they are not jointly and severally liable and therefore will not be as between themselves entitled to contribution from one another. Of course, the Bank would be entitled to recover only once but may pursue one or the other of them at its option. We remand to the trial court for further proceedings.

JULY 2011
ESSAY QUESTIONS 4, 5, AND 6

California Bar Examination

Answer all three questions.
Time allotted: three hours

Your answer should demonstrate your ability to analyze the facts in question, to tell the difference between material and immaterial facts, and to discern the points of law and fact upon which the case turns. Your answer should show that you know and understand the pertinent principles and theories of law, their qualifications and limitations, and their relationships to each other.

Your answer should evidence your ability to apply law to the given facts and to reason in a logical, lawyer-like manner from the premises you adopt to a sound conclusion. Do not merely show that you remember legal principles. Instead, try to demonstrate your proficiency in using and applying them.

If your answer contains only a statement of your conclusions, you will receive little credit. State fully the reasons that support your conclusions, and discuss all points thoroughly.

Your answer should be complete, but you should not volunteer information or discuss legal doctrines which are not pertinent to the solution of the problem.

Unless a question expressly asks you to use California law, you should answer according to legal theories and principles of general application.

Question 4

Austin had been a practicing physician before he became a lawyer. Although he no longer practices medicine, he serves on a local medical association committee that works to further the rights of physicians to be compensated fairly by health insurance providers. The committee develops recommendations, but its members do not personally engage in public advocacy. Austin is a close friend of several of the other physicians on the committee, though as a lawyer he has never represented any of them.

In his law practice, Austin represents BHC Company, a health insurance provider. BHC has been sued in a class action by hundreds of physicians, including some of Austin's friends, for unreasonable delay, and denial and reduction of reimbursements for medical services. Austin initially advised BHC that he was not confident it had a defense to the lawsuit. After further research, however, Austin discovered that a stated policy of the health care law is the containment of health care costs. He advised BHC that he could plausibly argue that reimbursements to physicians may legally be limited to avoid a dramatic increase in the health insurance premiums of patients. He explained that he would argue for a modification of existing decisional law to allow such a result based on public policy.

When Bertha, counsel for the class of physicians, heard the defense Austin planned to assert in the lawsuit, she wrote him a letter stating that if he presented that defense she would report him to the state bar for engaging in a conflict of interest.

1. What, if any, ethical violations has Austin committed as an attorney? Discuss.

2. What, if any, ethical violations has Bertha committed? Discuss.

Answer according to California law and ABA authorities.

Question 5

Prior to 1975, Andy owned Blackacre in fee simple absolute. In 1975, Andy by written deed conveyed Blackacre to Beth and Chris "jointly with right of survivorship." The deed provides: "If Blackacre, or any portion of Blackacre, is transferred to a third party, either individually or jointly, by Beth or Chris, Andy shall have the right to immediately re-enter and repossess Blackacre."

In 1976, without the knowledge of Chris, Beth conveyed her interest in Blackacre to Frank.

In 1977, Beth and Frank died in a car accident. Frank did not leave a will and his only living relative at the time of his death was his cousin Mona.

In 1978, Chris and Andy learned that Beth had conveyed her interest in Blackacre to Frank. When Mona approached Chris a day later to discuss her interest in Blackacre, Chris told her that he was the sole owner of Blackacre and she had no interest in Blackacre. Chris posted "No Trespassing" signs on Blackacre. He also paid all of the expenses, insurance, and taxes on Blackacre. Andy and Mona have never taken any action against Chris' possession of Blackacre.

1. What right, title, or interest in Blackacre, if any, did Andy initially convey to Beth, Chris, and himself? Discuss.

2. What right, title, or interest in Blackacre, if any, are held by Andy, Chris, and Mona? Discuss.

Question 6

In 2003, Wendy and Hank were engaged to be married. They discovered that the $10,000 monthly income Wendy derived from a trust fund would terminate upon her marriage or upon her reaching the age of 25, whichever came first. Therefore, they decided to postpone their wedding until Wendy's 25th birthday, in 2006, and instead began to live together.

Also in 2003, Wendy and Hank agreed that Wendy would pursue a master's degree in education and that Hank would quit his job and stay home, taking care of the household chores. Wendy opened a checking account in both of their names, into which she deposited her $10,000 monthly trust income. Wendy used funds in the checking account to pay living expenses for Hank and herself. Wendy also used funds in the checking account to buy a new car. She put title to the car in both of their names.

In 2006, Wendy and Hank married. Wendy's $10,000 monthly trust income terminated. Afterwards, Wendy began teaching at a local college.

In 2008, Wendy learned that her compensation was less than that of her male counterparts and made a claim against the college.

In 2009, Wendy separated from Hank and filed an action for dissolution of marriage. Shortly afterwards, she settled her claim against the college in return for additional salary in the amount of $10,000 per year for the next three years.

Unbeknownst to Wendy, Hank had run up a gambling debt to a casino during their marriage. At the time of their separation, Hank owed the casino $50,000.

Upon dissolution of marriage, what are Wendy's and Hank's rights and liabilities with respect to:

1. The car? Discuss.

2. The $30,000 in additional salary under the settlement? Discuss.

3. The $50,000 owed to the casino? Discuss.

Answer according to California law.

JULY 2011

California
Bar
Examination

Performance Test B

INSTRUCTIONS AND FILE

DAVID v. SOVEREIGN AUTO STORE, INC.

FILE

DAVID v. SOVEREIGN AUTO STORE, INC.

INSTRUCTIONS

1. You will have three hours to complete this session of the examination. This performance test is designed to evaluate your ability to handle a select number of legal authorities in the context of a factual problem involving a client.
2. The problem is set in the fictional State of Columbia, one of the United States.
3. You will have two sets of materials with which to work: a File and a Library.
4. The File contains factual materials about your case. The first document is a memorandum containing the instructions for the tasks you are to complete.
5. The Library contains the legal authorities needed to complete the tasks. The case reports may be real, modified, or written solely for the purpose of this performance test. If the cases appear familiar to you, do not assume that they are precisely the same as you have read before. Read each thoroughly, as if it were new to you. You should assume that cases were decided in the jurisdictions and on the dates shown. In citing cases from the Library, you may use abbreviations and omit page citations.
6. You should concentrate on the materials provided, but you should also bring to bear on the problem your general knowledge of the law. What you have learned in law school and elsewhere provides the general background for analyzing the problem; the File and Library provide the specific materials with which you must work.
7. Although there are no restrictions on how you apportion your time, you should probably allocate at least 90 minutes to reading and organizing before you begin preparing your response.
8. Your response will be graded on its compliance with instructions and on its content, thoroughness, and organization.

The Law Firm of Rogers and Snider
7533 Morningside Drive
Shepard, Columbia

DATE: July 28, 2011
TO: Applicant
FROM: Martin Snider, Partner
RE: David v. Sovereign Auto Store, Inc.

We represent Joe David, a low-income client whose case we have taken pro bono, in an action against a car dealership that charged him more than twice the retail value of a used car. He was unable to afford the payments and the car was repossessed. The dealership has not yet taken legal action to collect on the balance of the loan. Because the dealership cheated him, we filed an action against it.

After serving the Complaint, I got a letter from opposing counsel demanding that we submit the claim to arbitration. I find a number of problems with the arbitration clause and want to refuse to arbitrate and to oppose the motion she intends to file.

Please draft a memorandum of points and authorities opposing counsel's expected motion to compel arbitration. Follow the firm's guidelines for persuasive memos that is attached.

The Purchase Agreement contains boilerplate language but we are only concerned here with the arbitration provisions in paragraphs 4 and 5. Don't spend your time now on any other issues. I want your help only with the issue of whether the mandatory arbitration clause is enforceable.

The Law Firm of Rogers and Snider
7533 Morningside Drive
Shepard, Columbia

MEMORANDUM

TO: Attorneys
FROM: Martin Snider
RE: **Persuasive Briefs and Memoranda**

To clarify the expectations of the office and to provide guidance to attorneys, all persuasive briefs or memoranda, such as memoranda of points and authorities to be filed in court, shall conform to the following guidelines.

All of these documents shall contain a Statement of Facts. Select carefully the facts that are pertinent to the legal arguments. The facts must be stated briefly, cogently, and accurately, although emphasis is not improper. The aim of the Statement of Facts is to persuade the tribunal that the facts support our client's position.

Following the Statement of Facts, the argument should begin. This firm follows the practice of writing carefully crafted subject headings that illustrate the arguments they cover. The argument heading should succinctly summarize the reasons the tribunal should take the position you are advocating. A heading should be a specific application of a rule of law to the facts of the case and not a bare legal or factual conclusion or statement of an abstract principle. For example, **IMPROPER**: DEFENDANT HAD SUFFICIENT MINIMUM CONTACTS TO ESTABLISH PERSONAL JURISDICTION. **PROPER**: A RADIO STATION LOCATED IN THE STATE OF FRANKLIN THAT BROADCASTS INTO THE STATE OF COLUMBIA, RECEIVES REVENUE FROM ADVERTISERS LOCATED IN THE STATE OF COLUMBIA, AND HOLDS ITS ANNUAL MEETING IN THE STATE OF COLUMBIA HAS SUFFICIENT MINIMUM CONTACTS TO ALLOW COLUMBIA COURTS TO ASSERT PERSONAL JURISDICTION.

The body of each argument should analyze applicable legal authority and

persuasively argue how the facts support our position. Authority supportive of our client's position should be emphasized, but contrary authority should generally be cited, addressed in the argument, and explained or distinguished. Do not reserve arguments for reply or supplemental briefs.

Finally, there should be a short conclusion stating why our client should prevail.

Attorneys should not prepare a table of contents, a table of cases, or the index. These will be prepared after the draft is approved.

Memo to File

Notes from interview with Joe David, May 30, 2011

Client Joe David was referred to us from The State Bar of Columbia Pro Bono Project for consumer debt problem regarding an automobile repossession. Client is a 25 year-old single father of three children (ages 1, 3 and 11). He drives a school bus for the Bryant Board of Education.

He bought a used car, a 2005 Mazda Tribute, at Sovereign Auto Store (SAS). He went to SAS because they advertise heavily on TV about good reliable used cars for low monthly payments. He also drives by the dealership while driving to work in the morning. His old car was having mechanical problems plus he wanted an SUV. In July 2009, his car wouldn't start and he had to get a jump start. That day he drove to SAS and was greeted by a saleswoman, "Ann." He said she was very likeable and she asked him what he was looking for. He said that he wanted to buy an SUV and that the most he could afford was $200 a month. Ann asked if he had a copy of his paystub and he gave her his last two and she said she would check with the credit department. She came back about 15 minutes later and told him she had "good news." She said that he qualified for a loan of $389 a month and that she had a perfect car for him at that price.

Client remembers repeating that he could only afford $200 but the saleswoman said that they had run the numbers and he could afford more and that he at least ought to look at what that amount of money would buy. She led him into the showroom at the back of the building and the Mazda was sitting there, "clean and shiny." He said that he liked everything about it and that he testdrove it with her seated next to him the whole way. He told her that he wanted to buy the car. He doesn't remember her saying the total price until she brought the papers to him to sign.

I asked him if he tried to negotiate the price of the car. He said that he didn't know that you were supposed to do that. He seemed embarrassed by the question and said that he trusted Ann to give him the right price. I asked him if he had ever bought a car before and he said that his first car was his uncle's car and that he gave it to him about 7 years ago. He traded it in when he bought this car.

I asked him if he read the contract before signing it and he said that it was full of tiny print so he did not and the saleswoman told him that this was the paper that everyone had to sign to buy a car. He thinks they gave him a copy but he left it in the glove compartment of the car and now the car has been repossessed.

The letter he brought in from the bank that financed the car said that they charged him $19,955 for the car. Mr. David made all of the payments until he could no longer work because his doctor advised him to temporarily stop working, due to an unrelated health issue.

It is unclear how many months Mr. David eventually fell behind. He attempted to pay his house payment one month and the car payment the next. Mr. David believes he was only two months behind when he was contacted about his delinquency. Mr. David then attempted to refinance the car because the payments were too high. His credit union informed him that they could not refinance the car because its value was only $8,800. SAS has demanded more than $13,000 from him to repay the loan.

I researched the Kelly Blue Book value for the 2005 Mazda Tribute at the time that Mr. David purchased the car — it was $9,775. I think they really took advantage of him.

His current finances are as follows:

Income:	
Monthly take home pay	$1,725
Expenses:	
Mortgage Payment per month	$715
Utilities (average)	$250
Daycare	$295
Food (varies)	$200
Transportation	$100
Cell phone	$55
Total:	**$1,615**

IN THE SUPERIOR COURT OF BRYANT
CIVIL DIVISION

JOE DAVID,	)	
Plaintiff	)	
v.	)	Civil Case No. 2011-12073
	)	
SOVEREIGN AUTO STORE, INC.,	)	**COMPLAINT**
Defendant	)	
	)	
_____	)	

Plaintiff, Joe David, respectfully states:

STATEMENT OF THE CASE

Defendant Sovereign Auto Store, Inc. (SAS) took advantage of Plaintiff Joe David, an unsophisticated consumer, by fraudulently selling him a car for more than twice its fair market value.

PARTIES

1. Plaintiff Joe David resides at 502 Maple Street, Bryant, Columbia. Plaintiff purchased a used car from Defendant SAS.
2. Defendant SAS is a Columbia corporation, located at 1105 Albemarle Road, Bryant, Columbia.

FACTUAL ALLEGATIONS

3. On or about July 28, 2009, Plaintiff went to the SAS in Bryant, Columbia with the intent to purchase a used car.
4. Plaintiff told the SAS salesperson he could only afford a vehicle with payments of $200 per month or less based on his then-current income and expenses.
5. Plaintiff showed the SAS salesperson his pay stubs demonstrating his current income.
6. The SAS salesperson then calculated the total loan amount he was eligible to borrow.
7. Based upon Plaintiff's desire to purchase an SUV, the SAS salesperson showed him a 2005 Mazda Tribute.

8. The SAS salesperson knew the actual fair market value of the car but withheld that information from Plaintiff.

9. Instead, the SAS salesperson told him the price was $389 per month, for a total of $19,955.00, which was at least twice the value of the car.

10. In 2005, the base price for a brand new top model 2005 Mazda Tribute was $23,025.00.

11. Plaintiff, an unsophisticated consumer, is a high-school educated public school bus driver.

12. Plaintiff trusted the SAS salesperson and was led to believe that the car was equivalent in value to its purchase price and thus relied on the representation by SAS. Plaintiff would not have purchased the car had he known that its value was less than half of the SAS sales price.

13. Plaintiff purchased the car sold by SAS, a used 2005 Mazda Tribute, for the purchase price of $19,955.00.

14. Plaintiff financed the car through SAS or its agents. The terms of the loan required the Plaintiff to pay monthly installments of $389 for 72 months.

15. Between September 2009 and July 2010, Plaintiff made regular loan payments in accordance with the aforesaid loan agreement.

16. Unable to afford the high monthly payments on his limited income, Plaintiff fell behind in one payment for the months of July through November 2010. Plaintiff was unable to make regular payments after November 2010.

17. Defendant repossessed Plaintiff's car in December 2010. Defendant allegedly sold the car at auction for $6,125 and subsequently demanded payment of $13,368.95 in a letter dated May 15, 2011.

18. As a result of Defendants' actions, Plaintiff suffered loss of money and diminished credit rating.

FIRST CAUSE OF ACTION

UNLAWFUL TRADE PRACTICES

19. Defendants violated Columbia Consumer Protection Procedures Act (CCPPA), specifically the Unfair Trade Practices Act, by charging an unconscionable price and by knowingly taking advantage of Plaintiff's

inability to reasonably protect his interests. Specifically, Defendants charged an exorbitant price far exceeding the car's retail value.

20. Plaintiff suffered damages as a result, as iterated in paragraph 18.

SECOND CAUSE OF ACTION

FRAUDULENT MISREPRESENTATION

21. Defendant committed the common law tort of fraudulent misrepresentation under the law of the State of Columbia. Defendant SAS made a false representation to Plaintiff by knowingly withholding the fair market value of the car from Plaintiff and led Plaintiff to believe the price charged was reasonably proportionate to the car's value.

22. This was a misrepresentation of a material fact that Defendant knew and intentionally did not disclose.

23. Plaintiff relied on the misrepresentation to his detriment, suffering injury as a result, as iterated in paragraph 18.

PRAYER FOR RELIEF

WHEREFORE, Plaintiff respectfully requests that this Court find Defendant SAS liable for violation of Columbia consumer protection statutes, and fraud or misrepresentation. Plaintiff requests the following:

1. The original sales installment contract for the purchase of the car be deemed as null and void and all remaining alleged debt relating to the car be released.
2. The Defendant be required to pay the Plaintiff compensatory damages of $5,483, a sum equal to a refund of payments made, plus other expenses associated with repair and repossession.
3. The Defendant be required to pay Plaintiff treble damages pursuant to the Columbia Consumer Protection Code.
4. The Defendant be required to pay court costs.
5. The Defendant be required to pay punitive damages.
6. That the court grant costs, attorney fees and any further relief as it may deem to be necessary and proper.

//

//

JURY TRIAL DEMAND

Plaintiff demands a trial by jury.

Dated: July 8, 2011

Martin Snider

Martin Snider, Attorney
7533 Morningside Drive
Shepard, Columbia

Burke and Rice
Attorneys-at-Law
1201 Diego Road
Bryant, Columbia
(555)274-4141

July 26, 2011

Mr. Martin Snider, Esq.
The Law Firm of Rogers and Snider
7533 Morningside Drive
Shepard, Columbia

RE: David v. Sovereign Auto Store, Inc.;
Superior Court of Bryant Case No.: CA 2011-12073

Dear Mr. Snider:

On behalf of my client, Sovereign Auto Store, Inc. (SAS), I seek your consent to submit this case to arbitration, as required by the contract between the parties. If you do not agree, it is my intention to file a Motion to Dismiss and Compel Arbitration with the court. As you know, I am required by court rule to seek your consent prior to filing any motion and thus will inform the court if you do not do so.

Your client's Complaint arises from his purchase of a 2005 Mazda Tribute from SAS's dealership located here in Bryant. The Purchase Agreement contains a mandatory arbitration clause that covers the situation alleged in your Complaint. In essence, this action involves belated claims by a disgruntled purchaser of a used car. Your client concedes that after discussions with the salesperson, he voluntarily agreed to purchase the vehicle, yet now claims that SAS committed fraud, engaged in unlawful trade practices and violated the common law by entering into an unconscionable contract because the negotiated purchase price he agreed to pay for the vehicle was too high and the salesperson "knew the actual fair market value of the car but withheld that information from him." This is precisely the kind of claim that is subject to arbitration under the terms of the contract.

In case you do not have it, I have attached a copy of the Purchase Agreement entered into some two years ago. As you will note, it is a standard contract that my client uses for every used car sale. I call your attention to Paragraph 5 for the terms of

the arbitration agreement, which is located above your client's signature. Paragraph 5 states:

> **"5. YOU ACKNOWLEDGE THAT THIS PURCHASE AGREEMENT CONTAINS AN AGREEMENT TO ARBITRATE DISPUTES, AND THAT YOU HAVE READ THE ARBITRATION PROVISION, AND THAT YOU AGREE TO ITS TERMS."**

I am sure you will agree that this clause is unambiguous. In my experience, arbitration is an expeditious way of resolving disputes. As his share of the costs of arbitration, your client will have to pay a $250 filing fee to initiate arbitration and a minimum deposit of $1,500 covering two days of proceedings at $750 per day. Please let me know within three (3) days whether you will agree to submit this case to arbitration and I will move quickly to propose an arbitrator to you.

Sincerely,

Paula Burke

Paula Burke
Attorney-at-Law

Purchase Agreement for Used Car

July 28, 2009
Date

Sovereign Auto Store, Inc.
1105 Albemarle Road
Bryant, Columbia 90000
Tel: (555)555-1701

Joe David
Purchaser
502 Maple Street
Address
Bryant, Columbia 90002
City, State, Zip Code
(555)871-2629
Phone numbers

Mileage: 68,333
Please enter my order for the following used vehicle:
2005 Mazda Tribute LX 4 DR SUV, Tan Serial 4F2CUP18ZHR2566KM52057
Salesperson: Ann Anthony

Cash Delivered Price of Vehicle:	$19,955.00
Used Car Trade-In Value:	$200.00
Subtotal:	$19,775.00
Sales Tax:	$1,186.50
Tags and Registration Fee:	$145.00
Total:	**$21,086.50**

1. This purchase agreement (Agreement) contains the full and final agreement between the parties concerning the purchase of the Vehicle and supersedes and replaces all prior or contemporaneous agreement between the parties.

2. If any provision of the Agreement, or the application of such provision to any person or circumstance, shall be held to be invalid, the remainder of this Agreement shall not be affected.

3. Warranty Limitations - DEALER HEREBY EXPRESSLY DISCLAIMS ALL WARRANTIES, EITHER EXPRESS OR IMPLIED, INCLUDING ANY IMPLIED WARRANTY OF MERCHANTABILITY OR FITNESS FOR A PARTICULAR PURPOSE.

4. Arbitration Terms - The parties agree that all disputes, claims or controversies arising from or relating to the Purchaser's purchase of the Vehicle, including all Disputes arising under case law, statutory law, and all other laws, shall be resolved by binding arbitration by one arbitrator located in the State of Columbia selected by the Dealer

with the consent of the Purchaser. The parties agree and understand that they choose arbitration instead of litigation to resolve disputes. The parties understand that they have a right or opportunity to litigate disputes through a Court, but that they prefer to resolve their disputes through arbitration, except that the Dealer may proceed with Court action in the event the Purchaser fails to pay any sums due under the Agreement. THE PARTIES VOLUNTARILY AND KNOWINGLY WAIVE ANY RIGHT THEY HAVE TO JURY TRIAL EITHER PURSUANT TO ARBITRATION UNDER THIS CLAUSE OR PURSUANT TO COURT ACTION. The parties agree that the cost of arbitration shall be borne equally between the parties provided, however, that the arbitrator may, in the interests of justice, order that the losing party pay the prevailing party's costs. A Dispute is any allegation concerning a violation of state or federal statute that may be the subject of binding arbitration, any purely monetary claim greater than $1,000.00 in the aggregate. Provided, however, that your failure to provide consideration to be paid by you (including your failure to pay a note, a dishonored check, or failure to provide a trade title) as well as our right to retake possession of the vehicle pursuant to this Purchase Agreement shall not be considered a Dispute and shall not be subject to arbitration. The parties agree that to the extent damages are awarded, they shall be limited to the total amount paid by the Purchaser for the Vehicle plus other provable economic loss as determined in the sole discretion of the arbitrator.

5. YOU ACKNOWLEDGE THAT THIS PURCHASE AGREEMENT CONTAINS AN AGREEMENT TO ARBITRATE DISPUTES, AND THAT YOU HAVE READ THE ARBITRATION PROVISION, AND YOU AGREE TO ITS TERMS.

Date: July 28, 2009

Joe David

Purchaser

Date: July 28, 2009

Ann Anthony

Dealer's Representative

JULY 2011

California
Bar
Examination

Performance Test B

LIBRARY

DAVID v. SOVEREIGN AUTO STORE, INC.

LIBRARY

Medina, et al. v. Core Healthcare Services
Supreme Court of Columbia (2000)

Mary Medina and Bonita Orate (the employees) filed a complaint for wrongful termination against their former employer, Core Healthcare Services (the employer). We consider the validity of an agreement imposed on a prospective or current employee as a condition of employment to arbitrate wrongful termination or employment discrimination claims rather than file suit in court. We conclude that antidiscrimination claims brought under the Columbia Fair Employment Act (CFEA) are arbitrable only if the arbitration permits an employee to vindicate his or her statutory rights. We also find the mandatory arbitration clause's limitation on damages and its unilateral obligation to arbitrate contrary to public policy unconscionable. The trial court refused to enforce the arbitration agreement, but the Court of Appeal enforced the agreement minus the provision it found unconscionable. We conclude that the arbitration agreement is unenforceable and reverse the Court of Appeal's judgment.

Both employees had signed employment application forms including an arbitration clause pertaining to any future claim of wrongful termination. The clause states in full:

> "I agree that, as a condition of my employment, in the event my employment is terminated and I contend that such termination was wrongful or otherwise in violation of the conditions of employment or was in violation of any express or implied condition, term or covenant of employment, whether founded in fact or in law, I will submit any such matter to binding arbitration. I further agree that, in any such arbitration, my exclusive remedies for violation of the terms, conditions or covenants of employment shall be limited to a sum equal to the wages I would have earned from the date of any discharge until the date of the arbitration award. I understand that I shall not be entitled to any other remedy, at law or in equity, including but not limited to reinstatement and/or injunctive relief."

The Columbia Arbitration Act (CAA), like federal law, favors enforcement of valid arbitration agreements, including agreements to arbitrate statutory rights. Arbitration agreements are valid, irrevocable, and enforceable and may be invalidated only for the same reasons as other contracts. The CAA contains no exemption for employment contracts.

The inquiry under the CAA is: Do general contract law principles provide reasons for refusing to enforce the present arbitration agreement? The answer turns on whether and to what extent the arbitration agreement is contrary to public policy or unconscionable.

Arbitration of CFEA Claims

Litigants, in arbitrating a statutory claim, do not forgo the substantive rights afforded by the statute but only submit them to resolution through arbitration; thus, arbitration agreements and practices that compel claimants to forfeit certain statutory rights are unenforceable. While some statutory rights can be waived, arbitration agreements that encompass *unwaivable* statutory rights require great scrutiny based on two principles of public policy. First, contracts exempting anyone from responsibility for fraud or willful injury to another, or from violation of law, are against public policy and may not be enforced. Second, anyone may waive the advantage of a law intended solely for his benefit, but a law established for a public reason cannot be contravened by a private agreement.

The statutory rights of the CFEA serve important public purposes: safeguarding the right and opportunity of all persons to seek, obtain, and hold employment without discrimination or abridgement on account of race, religious creed, color, national origin, ancestry, physical handicap, medical condition, sexual orientation, marital status, sex or age. The public policy against sex discrimination and sexual harassment in employment inures to the benefit of the public, not just a particular employer or employee. An employment contract that requires employees to waive their rights under the CFEA to redress sexual harassment or discrimination is contrary to public policy and unlawful. An arbitration agreement cannot serve as a vehicle for the waiver of statutory rights created by the CFEA.

In determining whether arbitration is an adequate forum for securing rights under CFEA, we note the differences involved in arbitrating employees' statutory rights and disputes arising from collective bargaining agreements. The fundamental distinction between contractual rights which are created, defined, and subject to modification by the parties, and statutory rights which are created, defined, and subject to modification only by the legislature and the courts, suggests the need for a public rather than private

mechanism of enforcement. The beneficiaries of public statutes are entitled to the rights and protections provided by the law.

We identify three minimum requirements for the arbitration of such rights pursuant to a mandatory employment arbitration agreement. It must provide for: (1) neutral arbitrators; (2) all types of relief available in court; and (3) it must not require employees to pay arbitrator's fees or expenses that make a forum inaccessible. The only issue in this case is the limitation on remedies.

Limitation of Remedies

An arbitration agreement may not limit statutorily imposed remedies such as punitive damages and attorney fees. This arbitration agreement imposes exclusive remedies limited to wages earned from the discharge date until the date of the arbitration award. The agreement compels arbitration of statutory claims without affording the full range of statutory remedies, including punitive damages and attorney fees. This damages limitation is contrary to public policy and unlawful.

Unconscionability of the Arbitration Agreement

1. *General Principles of Unconscionability*

We now consider objections to mandatory arbitration that apply to any type of claim. These objections fall under the rubric of unconscionability. Unconscionability has both procedural and substantive elements, the former focusing on oppression or surprise due to unequal bargaining power, the latter on overly harsh or one-sided results. For a court to refuse to enforce a contract or clause, both procedural and substantive unconscionability must be present, but not in the same degree. The more substantively oppressive the contract term, the less evidence of procedural unconscionability is required and vice versa.

Because unconscionability applies to contracts generally, a court can refuse to enforce an arbitration agreement under the CAA, which provides that arbitration agreements are "valid, enforceable and irrevocable, save upon such grounds as exist for the revocation of any contract."

2. *Unconscionability and Mandatory Employment Arbitration*

We find that this arbitration agreement is procedurally unconscionable. It was imposed as a condition of employment and the employees had no opportunity to negotiate.

Arbitration is favored in Columbia as a voluntary means of resolving disputes, and this voluntariness is its bedrock justification. Given the lack of choice and the disadvantages of even a fair arbitration system for employees, we are particularly vigilant when employers with superior bargaining power impose one-sided, substantively unconscionable terms in the arbitration clause.

The agreement is also substantively unconscionable because it requires only employees but not the employer to arbitrate claims. The party required to submit claims to arbitration forgoes many rights and benefits associated with a judicial forum, while the party requiring waiver retains all the benefits and protections. The unilateral obligation is so one-sided as to be substantively unconscionable.

3. *Severability of Unconscionable Provisions*

When a court finds unconscionability, it may refuse to enforce the contract or enforce the remainder of the contract without the unconscionable clause, or it may limit the application of any unconscionable clause to avoid an unconscionable result. The former course is appropriate when an agreement is permeated by unconscionability. Two reasons favor severing or restricting unconscionable terms. The first is to prevent parties from gaining undeserved benefit or suffering undeserved detriment from voiding the agreement. Second, severance attempts to conserve a contractual relationship if to do so does not condone an illegal scheme. The overarching inquiry is whether severance furthers the interests of justice.

In this case, two factors weigh against severance of the unlawful provisions in the arbitration agreement. First, the arbitration agreement contains more than one unlawful provision -- an unlawful damages provision and an unconscionable unilateral arbitration clause. Multiple defects indicate a systematic effort to impose arbitration not as an alternative to litigation but to gain advantage. Second, permeation appears from the fact that there is no single provision a court can strike or restrict to remove the unconscionable taint from the arbitration agreement. The court would have to reform the contract by

substituting terms. When a court is unable to cure unconscionability through severance or restriction, voiding the arbitration agreement may serve the interests of justice. Here, the various provisions that are unconscionable and contrary to public policy make the mandatory arbitration agreement unenforceable as a whole.

The approach described above is consistent with our case of *Marshall v. Fermby* (1981) Col. Sup. Ct., in which we found an arbitration agreement unconscionable because it provided for an arbitrator likely to be biased in favor of the party imposing the agreement. Relying on the methods for appointing an arbitrator provided in the CAA when the arbitration agreement does not provide a method for appointing an arbitrator, the court remanded and instructed the trial court to follow the procedures of the CAA. Thus, an arbitration clause providing for a less-than-neutral arbitration forum is severable because the arbitration statute itself gave the court the power to reform the agreement. No comparable provision in the arbitration statute enables the court to reform the defects here.

Reversed and remanded to the Court of Appeal with directions to affirm the judgment of the trial court.

Fillman v. Cornado Homes, Inc.
State of Columbia, Court of Appeal (2001)

Heidi Fillman (Fillman), proceeding *in forma pauperis*, brings this action against Cornado Homes, Inc. (Cornado) for damages arising out of Fillman's purchase of a manufactured home under a retail installment contract. Fillman alleges violations of the Truth in Lending Act (TILA), Columbia's Uniform Commercial Code, and common law trespass. Cornado filed a motion to compel arbitration. Finding that the contract's arbitration clause precludes Fillman from vindicating her statutory rights under the TILA because the arbitral forum is financially inaccessible, the court denies Cornado's motion.

Fillman executed a retail installment contract, effective March 31, 2000, with Cornado for the installment purchase of a manufactured home for herself and her three young children. The contract was a pre-printed form provided by Cornado and contained an arbitration clause that provides, in pertinent part, as follows:

> **ARBITRATION OF DISPUTES AND WAIVER OF JURY TRIAL:** Any controversy or claim between you and me or our assignees arising out of or relating to the contract or any agreements or instruments relating to or delivered in connection with this contract, including any claim based on or arising from an alleged tort, shall, if requested by either you or me, be determined by arbitration. **YOU AND I AGREE AND UNDERSTAND THAT WE ARE GIVING UP THE RIGHT TO TRIAL BY JURY, THERE SHALL BE NO JURY AND THE CONTROVERSY OR CLAIM WILL BE DECIDED BY ARBITRATION.**

The arbitration clause does not mention the costs of arbitration or which party is responsible for paying them. However, the contract provides that "the Commercial Rules of the American Arbitration Association . . . apply" to any arbitration arising from the contract.

Fillman brought this suit on March 28, 2001. On the same day, the court granted Fillman's application to proceed *in forma pauperis*, thereby exempting her from the court's $150 filing fee. On May 25, 2001, Cornado moved to compel arbitration, which Fillman opposed arguing, in part, that the arbitration provision interferes with vindication

of her statutory rights under the TILA and is unconscionable because the fees associated with the arbitration prohibit her access to the arbitral forum.

The parties stipulate to the following facts: According to the Commercial Arbitration Rules of the American Arbitration Association (AAA), a party initiating a claim the size of Fillman's (between $75,000 and $150,000) must pay an initial filing fee of $1,250, and, after a scheduling conference, a case fee of $750. If the initiating party ultimately prevails, the arbitrator may award those fees to her in the final disposition of the case. The initiating party may apply for a waiver, reduction, or deferral (complete or partial) of these fees due to extreme hardship. The AAA's accounting department determines which claimants receive extreme hardship status. No formal standards govern the accounting department's determination. In practice, the complete waiver of a fee is extremely rare; partial deferral is the usual response. The arbitrator may assess the losing party the deferred fee as part of the final award.

After a party initiates a claim with the AAA, the parties may not proceed until they pay the arbitrator's fee and expenses. Each party is responsible for half those costs. The arbitrator selected by the parties sets the arbitration fee, which typically ranges between $100 and $300 per hour, for a minimum of one full day for hearings, plus the arbitrator's additional preparation and research time before and after the hearing. Arbitrators customarily charge their hourly rate for travel time. Thus, the arbitration will not proceed until both parties pay their half of the arbitrator's fees. Fillman suggests that the total amount of an arbitrator's fees will likely range between $1,200 (assuming $100 hourly fees for one hearing plus time for preparation and resolution without travel or other expenses) and $8000 (assuming $300 hourly fees for 24 hours of hearings, preparation, resolution, and travel, plus accommodation expenses).

On July 26, 2001, Fillman filed a declaration of her financial condition, stating that she provides sole support for herself and her three children. Though entitled to child support amounting to $600 per year, she rarely is able to collect payments. Fillman works as a waitress at a local restaurant where she earns an average weekly income, including tips, of $300 and attends Community College part-time. She owes $14,125 in old student loans which have been deferred until she finishes school. Due to her limited

income, her family shares a house with another family. Her share of those expenses consists of the following monthly amounts: electricity, including heat and well pump, $60-75; telephone, $20; food, $430. She is solely responsible for the following monthly expenses: daughter's drug prescriptions, $40; car payments, $260; car insurance, $128; gasoline, $100; and occasional expenses for clothes and other needs. She expects to spend about $300 for back-to-school clothes and supplies for her young children, for whom she shops at thrift stores. Fillman cannot afford health insurance, and she currently owes Community Hospital $445. Fillman declares that she cannot afford to pay costs associated with the adjudication of her dispute.

To decide whether statutory claims may be arbitrated, a court must resolve a threshold issue. The court must determine whether the parties agreed to submit their claims to arbitration. The court finds that the parties agreed to arbitrate the claims. Fillman voluntarily signed the contract. She alleges that Cornado did not provide her an opportunity to read the contract before signing it. The failure to provide such an opportunity is of no consequence. A party to a written contract is responsible for informing herself of its contents before executing it, and in the absence of fraud or overreaching she cannot impeach the effect of the instrument by showing that she was ignorant of its contents or failed to read it.

However, in Medina, the Supreme Court held that a mandatory arbitration agreement may not require employees to pay arbitrators fees or expenses that make the forum inaccessible. Therefore, the court must determine whether Fillman has demonstrated that the arbitration clause at issue prevents her from vindicating her rights under the TILA because the costs of arbitration make that forum inaccessible.

The court finds that Fillman has adequately demonstrated that the arbitral forum provided for in the contract is financially inaccessible to her; and therefore, fails to ensure that she can vindicate her statutory rights under the TILA. Here, Fillman has presented substantial evidence that the costs of arbitrating her claims would preclude her from vindicating her statutory rights.

The arbitration clause does not indicate directly which party will be responsible for the costs of initiating arbitration. Under the Commercial Rules of the AAA, Fillman

must pay an initial filing fee of $1,250 and a $750 case fee shortly thereafter. Fillman could not recover those fees, unless she ultimately prevailed on her claim. Even if she prevailed, Fillman does not have $2,000 to pay the fees in the first place, and she has no collateral with which to obtain a sufficient loan. Though Fillman may apply for fee deferral or reduction due to "extreme hardship," waiver of fees is extremely rare. The AAA does not provide standards for granting hardship, an issue determined by its accounting department.

Even if the initial $2000 in administrative fees were waived or deferred, Fillman has demonstrated that the additional costs of the arbitration process amount to an insurmountable financial barrier. To proceed, Fillman would be responsible for paying one-half of the anticipated fee and expenses of the arbitrator stated above. These fees are not subject to waiver or deferral for extreme hardship. In acknowledgment of Fillman's strained financial condition, this court found her unable to pay the $150 filing fee normally required to initiate the claim it now considers. In view of these facts, the court finds that Fillman's limited income affords no margin for expenses of the magnitude required to pay an arbitrator to consider her claim.

Fillman has demonstrated that the arbitration clause precludes her from vindicating the rights afforded by the TILA because the arbitral forum is financially inaccessible. The court concludes that the arbitration clause is unenforceable and denies Cornado's motion.

Marshall v. Fermby
Supreme Court of Columbia (1981)

Bill Marshall appeals from a judgment confirming an award by an arbitrator. We reverse and direct the trial court to vacate its order compelling arbitration.

Marshall is an experienced promoter and producer of musical concerts. Leon Fermby is a successful performer and recording artist. He is also a member of the American Federation of Musicians (AFM). Early in 1973, Fermby requested Marshall, who had promoted a number of Fermby concerts, to structure a tour. Four contracts were prepared. Marshall signed all four contracts; Fermby signed only those relating to the Windsor and Beachland concerts, which were to occur on July 29 and August 5, 1973.

The four contracts were all prepared on an identical form known in the industry as an AFM form B contract. Aside from matters such as date and time, they differed from one another in only two areas -- the hours of employment and wage. The latter provided payment of 85% percent of the gross receipts after expenses and taxes.

The contracts did not state who would bear any eventual net losses. The forms also provided: "In accordance with the Rules and Regulations of the AFM, the parties will submit every claim, dispute, or controversy involving the musical services arising out of or connected with this contract and the engagement covered thereby for determination by the International Executive Board of the AFM or a similar board of an appropriate local thereof and such determination shall be conclusive, final and binding upon the parties."

The Windsor concert occurred as scheduled and had gross receipts of $173,000 with expenses of $236,000, resulting in a net loss of $63,000. The Beachland concert resulted in a net profit of $98,000. Following this concert, a dispute arose over who was to bear the loss sustained in the Windsor concert and whether that loss could be offset against the profits of the Beachland concert. Fermby said that under the contract Marshall was to bear all losses from any concert without offset. Marshall urged that, under standard industry practice and custom relating to 85/15 contracts, such losses

should accrue to Fermby without offset. With this dispute unresolved, Fermby declined to execute the contracts for the Long Island and Philadelphia concerts.

In October 1973, Marshall filed an action for breach of contract, declaratory relief, and rescission against Fermby. Fermby responded with a petition to compel arbitration. After ordering arbitration, the trial court granted reconsideration to permit discovery limited to the issues of whether an agreement to arbitrate was entered into and whether grounds existed to rescind such agreement.[1] Following discovery, including depositions, the court granted the petition and ordered arbitration.

On October 29, 1976, a hearing was held at the union's western office before a referee appointed by the union president. The referee was a former executive officer and a long-time member of the union who had been a hearing officer in previous union matters. Marshall produced considerable evidence that, under common custom and practice in the industry, the promoter under an 85/15 contract was understood to bear no risk of loss because his share of the profits was considerably smaller than under the normal contract, under which the promoter takes a larger percentage of the profits but is understood to bear the risk of loss. Fermby offered no contrary evidence.

In his report to the union's international executive board, the referee recommended that Marshall be ordered to pay Fermby the amount he claimed (some $53,000) at the arbitration. On February 22, 1977, the union's international executive board made its award in conformity with the recommendation of the referee.

The superior court denied Marshall's petition to vacate the award. Marshall appeals.

Marshall contends that the order was in error because, insofar as the underlying agreement required arbitration of disputes before the AFM, it was unenforceable because of unconscionability. Two separate questions are thus presented: (1) Is this procedurally unconscionable? (2) Is it substantively unconscionable?

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[1] The court shall decide whether an agreement to arbitrate exists or a controversy is subject to an agreement to arbitrate. Col. Arbitration Act § 2(b).

Procedural unconscionability signifies a standard contract, which, when imposed and drafted by the party of superior bargaining strength, relegates to the subscribing party only the opportunity to adhere to or reject the contract. While not lacking in social advantages, they bear the danger of oppression and overreaching. With this tension between social advantage and the danger of oppression, courts and legislatures have sometimes acted to prevent abuses.

The contract in question, in light of all of the circumstances, is procedurally unconscionable. Although Fermby insists that Marshall's prominence and success in the promotion of popular music concerts afforded him considerable bargaining strength, the record establishes that he, for all his stature in the industry, was reduced to the humble role of adherent. Marshall, whatever his asserted prominence in the industry, was required by the realities of his business to sign AFM form contracts with *any* concert artist and that he, wishing to promote the Fermby concerts, had the nonnegotiable option to accept the contracts on an 85/15 basis or not at all.

The Columbia Arbitration Act seems to contemplate complete contractual autonomy in the choice of an arbitrator. The Columbia Arbitration Act (CAA) § 29(a) provides that “if the parties to an agreement to arbitrate agree on a method for appointing an arbitrator, that method shall be followed, unless the method fails."

The CAA does not preclude parties from designating as arbitrator an entity or person who, by reason of relationship to a party, can be expected not to adopt a "neutral" stance. However, when as here the contract is adhesive, the possibility of overreaching looms large; we scrutinize contracts concluded in such circumstances to insure that the party of lesser bargaining power has a realistic and fair opportunity to prevail. Contracts must operate within a minimum level of integrity.

Courts must determine on a case-by-case basis this minimum level of integrity. Arbitration requires a *tribunal*, an entity or body that hears and decides disputes. An entity that is incapable of deciding based on what it has heard cannot act as a tribunal; one of the principal parties to the contract does not qualify.

The contract we here consider, insofar as it requires the arbitration of all disputes before the AFM, is substantively unconscionable. The minimum level of integrity

required for a contractual arrangement for the nonjudicial resolution of disputes is not achieved when the agreement designates the union of one of the parties as the arbitrator of disputes.

A contract provision designating a contractual party to serve as arbitrator is substantively unconscionable. The same result follows, and for the same reasons, when one whose interests are so allied with those of the party that, for all practical purposes, he is subject to the same disabilities. A contract is substantively unconscionable if it is overly harsh and one-sided.

We conclude that a contract provision designating the union of one of the parties as the arbitrator of disputes arising thereunder does not achieve the minimum level of integrity required of a contractually structured substitute for judicial proceedings. However, in light of the strong public policy of this state favoring resolving disputes by arbitration, the parties should not be precluded from using nonjudicial means of settling their differences. The parties have agreed to arbitrate but have named as arbitrator an entity that we cannot permit to serve in that capacity. In these circumstances, the parties should not be precluded from attempting to agree on an arbitrator. Upon remand, the trial court should afford the parties the opportunity to agree on a suitable arbitrator pursuant to § 29(a). In the absence of an agreement or petition to appoint, the court should proceed to a judicial determination.

We reverse and remand.

Unfair Trade Practices Act
Columbia Consumer Protection Code

§ 1. Purposes.

(a) The purposes of this chapter are to:

(1) assure that a just mechanism exists to remedy all improper trade practices and deter the continuing use of such practices;

(2) promote, through effective enforcement, fair business practices throughout the community; and

(3) educate consumers to demand high standards and seek proper redress of grievances.

(b) This chapter shall be construed and applied liberally to promote its purposes.

* * * *

§ 4. Unlawful trade practices.

It shall be a violation of this chapter, whether or not any consumer is in fact misled, deceived or damaged thereby, for any person to:

(a) misrepresent as to a material fact that has a tendency to mislead;

(b) fail to state a material fact if such failure tends to mislead;

(c) make or enforce unconscionable terms or provisions of sales or leases;

* * * *

§ 7. Remedies.

(a) The remedies provided in this section may not be waived.

(b) A person, whether acting for the interests of itself, its members, or the general public, may bring an action under this chapter in the Superior Court of the State of Columbia seeking relief from the use by any person of a trade practice in violation of a law of Columbia.

(c) A person may recover or obtain the following remedies:

(1) treble damages, or $ 1,500 per violation, whichever is greater, payable to the consumer;

(2) reasonable attorney's fees;

(3) punitive damages;

(4) an injunction against the use of the unlawful trade practice;

(5) in representative actions, additional relief as may be necessary to restore to the consumer money or property, real or personal, which may have been acquired by means of the unlawful trade practice; or

(6) any other relief which the court deems proper.

Columbia Arbitration Act

§ 26. Validity of agreement to arbitrate.

(a) An agreement contained in a record to submit to arbitration any existing or subsequent controversy arising between the parties to the agreement is valid, enforceable, and irrevocable except upon a ground that exists at law or in equity for the revocation of a contract.

(b) The court shall decide whether an agreement to arbitrate exists or a controversy is subject to an agreement to arbitrate.

* * * *

§ 28. Motion to compel or stay arbitration.

(a) On motion of a person showing an agreement to arbitrate and alleging another person's refusal to arbitrate pursuant to the agreement:

* * * *

(2) If the refusing party opposes the motion, the court shall proceed summarily to decide the issue and order the parties to arbitrate unless it finds that there is no enforceable agreement to arbitrate.

§ 29. Appointment of arbitrator; service as a neutral arbitrator.

(a) If the parties to an agreement to arbitrate agree on a method for appointing an arbitrator, that method shall be followed, unless the method fails. If the parties have not agreed on a method, the agreed method fails, or an arbitrator appointed fails or is unable to act and a successor has not been appointed, the court, on motion of a party to the arbitration proceeding, shall appoint the arbitrator. An arbitrator so appointed has all the powers of an arbitrator designated in the agreement to arbitrate or appointed pursuant to the agreed method.