

Multistate Performance Test

In re Steven Wallace



National Conference of Bar Examiners

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Preface

This Multistate Performance Test is a reprint of one of the three MPTs which were administered in July 1999.

The instructions for the test appear on the next page. On the actual MPT, they will appear on the back cover of the test.

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MULTISTATE PERFORMANCE TEST DIRECTIONS

You will be instructed when to begin and when to stop this test. Do not break the seal on this booklet until you are told to begin. This 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.

The problem is set in the fictitious state of Franklin, in the fictitious Fifteenth Circuit of the United States. Columbia and Olympia are also fictitious states in the Fifteenth Circuit. In Franklin, the trial court of general jurisdiction is the District Court, the intermediate appellate court is the Court of Appeal, and the highest court is the Supreme Court.

You will have two kinds of materials with which to work: a File and a Library. The first document in the File is a memorandum containing the instructions for the task you are to complete. The other documents in the File contain factual information about your case and may include some facts that are not relevant.

The Library contains the legal authorities needed to complete the task and may also include some authorities that are not relevant. Any cases may be real, modified, or written solely for the purpose of this examination. If the cases appear familiar to you, do not assume that they are precisely the same as you have read before. Read them thoroughly, as if they all were new to you. You should assume that the cases were decided in the jurisdictions and on the dates shown. In citing cases from the Library, you may use abbreviations and omit page references.

Your response must be written in the answer book provided. If you are using a laptop computer to answer the questions, your jurisdiction will provide you with specific instructions. In answering this performance test, you should concentrate on the materials in the File and Library. 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.

Although there are no restrictions on how you apportion your time, you should allocate approximately half your time to reading and digesting the materials and to organizing your answer before you begin writing it. You may make notes anywhere in the test materials; blank pages are provided at the end of the booklet. You may not tear pages from the question booklet.

Do not include your actual name anywhere in the work product required by the task memorandum.

This performance test will be graded on your responsiveness to the instructions regarding the task you are to complete, which are given to you in the first memorandum in the File, and on the content, thoroughness, and organization of your response.

In re Steven Wallace

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FILE

Piper, Morales & Singh
Attorneys at Law
One Dalton Place
West Keystone, Franklin 33322

M E M O R A N D U M

To: Applicant
From: Eva Morales
Date: July 27, 1999
Subject: Steven Wallace - Painting Titled "Hare Castle"

Steven Wallace, a long-time friend of mine, recently retired as Chair of the English Department at the University of Franklin to pursue full time what has until now been his avocation as an artist. He came in yesterday to get my advice and brought the documents I've included in the file. On reviewing the file, I can see that there are other facts we need in order to advise him properly.

About a year ago, Steven left one of his paintings, a canvas he had titled "Hare Castle," with Lottie Zelinka, an art dealer friend of his, with the understanding that she would try to sell it for him. Ms. Zelinka is the owner of Artists' Exchange, an art gallery here in West Keystone. Ten days or so ago, Ms. Zelinka returned the painting to Steven. A few days ago, he received a letter from Martin Feldner, a bankruptcy practitioner here in town. Mr. Feldner represents Charles Sims, the court-appointed Trustee in Bankruptcy. The letter advises Steven that Ms. Zelinka has filed for bankruptcy and demands that Steven turn "Hare Castle" over to the Trustee in Bankruptcy. Naturally, Steven is upset by this turn of events and wants to know how to respond.

Please draft for me a two-part memorandum:

First, analyze the legal and factual bases of the trustee's claim that the painting is an asset of the bankruptcy estate under the Bankruptcy Act and the Franklin Commercial Code (FCC).

Second, for each of the four defenses under FCC §2-326(3), discuss how the facts we already know support the defense, identify additional facts that might be helpful to us, state why they would be helpful, and indicate from what sources we might be able to obtain them.

Notes of July 26, 1999 Meeting with Steven Wallace

- Steven can't believe this letter he got (copy attached) two days ago—a bankruptcy attorney is demanding that Steven turn over one of his best paintings (“Hare Castle”) to a Trustee.
 - A friend of his, Lottie Zelinka, has an art gallery in West Keystone—the gallery is called Artists' Exchange. She operates it as a sole proprietorship.
 - Lottie has a sizeable inventory of paintings and sculptures—Steven thinks (but isn't sure) that most of the art in the gallery is on consignment from artists and that Lottie doesn't really own it. That's how Steven and every other artist he knows deal with the galleries in town—*i.e.*, by consignment. He's pretty sure that's how galleries work everywhere. Maybe Lottie owns some of the art, but, mainly, she shows the art, sells it for the artists, and makes her money on the sales commissions.
 - Steven thinks (but is not sure) Lottie had placed a sign in the window at the front of the gallery that said something like, “All offers will be considered and forwarded to the artists.”
- About a year ago, Lottie was at Steven's house for dinner with Steven and Ella, his wife. Lottie saw “Hare Castle” (oil on canvas—about 2' × 3') hanging on the dining room wall. She admired it and said she thought she could sell it for “a lot of money,” maybe as much as \$25,000 (some of Steven's recent paintings have been fetching pretty good prices, but he'd never thought about trying to sell “Hare Castle”—it was one of his favorite paintings and had been hanging in his dining room since he finished it a couple of years ago). Lottie told Steven, if he's interested, to bring it to her gallery and she'd put it up for sale.
- Steven and Ella talked it over and, although they had recently purchased a new rug for their dining room that coordinated with the colors in the painting, \$25,000 sounded like a lot of money, so they decided to see if Lottie was right. Steven took “Hare Castle” to Lottie's gallery, they did some paperwork (copies attached), and Steven left the painting with Lottie. He had put a label (about 2" × 3") on the back of the painting that said: “Hare Castle—Property of Steven Wallace (+ his address and phone number).”
- From time to time, Lottie called Steven to tell him about offers for the canvas—three offers all told—the highest one for \$6,000. Steven rejected them—not enough money.

- Maybe 10 days ago, Lottie called Steven at about 10 p.m.—told him she was going to come right over and leave “Hare Castle” at his house—she didn’t think she could sell it and she needed the space in the gallery. He thought it was strange, but he didn’t ask any questions and Lottie didn’t let on that anything was unusual. Now he realizes she tried to do him a favor by returning the painting—apparently, she filed for bankruptcy.
- Steven is now into painting full time—retired from Univ. of Franklin at the end of the last school year. His paintings seem to have caught on, and he’s been selling more and more of them (in fact, he has offered to buy back for \$750 paintings he originally sold for \$500—says he can probably sell them now for \$2,500).
- He now has a studio in a loft on Parker St.—up until now, he’s been working out of a spare room at home.
- Steven can’t believe he jeopardizes his paintings every time he puts them up for sale in a gallery!

ARTISTS' EXCHANGE
West Keystone's Premier Gallery
9 Wharf Alley
West Keystone, Franklin 33322
(555) 942-5060

Inventory Receipt

Date: August 15, 1998
 Artist: Steven Wallace
 Agent: none
 Address: 749 Galewood Circle
 West Keystone, Franklin 33322
 Phone: (555) 942-3342

Medium	Inventory Number	Size	Title	Artist's Net
Oil/Canvas	C 6076	2' x 3'	Hare Castle	Sale price minus 40% commission to Gallery

General Conditions:

The item(s) of artwork listed above is (are) being placed by the Artist or his/her agent, as consignor, on consignment with Artists' Exchange (Gallery), as consignee, to be sold by Gallery for the account of Artist. Artist retains title to the artwork until sold by Gallery. Gallery makes no representations regarding its ability to sell any or all of said artwork or the sales price thereof. Gallery may return artwork to Artist at any time if not sold. All offers shall be communicated to Artist by Gallery, and Artist shall have the right to accept or reject any offers. Artist shall have the right to determine price of sale, except that if an offer exceeds the appraised value of the artwork plus the amount of Gallery's commission, Artist shall be required to accept the offer. Risk of loss over and above amount of Gallery's liability and hazard insurance shall be borne by Artist. Artist's Net shall be paid to Artist upon payment in full of sale price by buyer.

Lottie Zelinka
 Artists' Exchange
 By: Lottie Zelinka

Steven Wallace
 Artist or Agent

APPRAISAL OF ARTWORK

Date: August 15, 1998

Title: "Hare Castle"

Artist: Steven Wallace

Medium: Original Oil on Canvas

Value: \$25,000.00

Owner: Steven Wallace

THE ABOVE INFORMATION IS TRUE AND
CORRECT TO THE BEST OF OUR KNOWLEDGE.

Signed: *Lottie Zelinka*
Lottie Zelinka

Title: Owner
ARTISTS' EXCHANGE

Martin R. Feldner
Attorney at Law
2298 West Arden Boulevard
West Keystone, Franklin 33322
(555) 942-4324

July 23, 1999

Mr. Steven Wallace
749 Galewood Circle
West Keystone, Franklin 33322

Re: In the Matter of Lottie Zelinka dba
Artists' Exchange
Bkpcy No. 980-7 (99)

Dear Mr. Wallace:

I represent Charles A. Sims, Trustee in Bankruptcy in the Chapter 7 bankruptcy case of Lottie Zelinka dba Artists' Exchange ("Debtor"). The Debtor filed a petition for bankruptcy under Chapter 11 of the Bankruptcy Act on May 25, 1999. She converted the case to a liquidation under Chapter 7 on July 19, 1999, on which date Mr. Sims was appointed trustee.

The Debtor has recently provided us with an accounting and business records detailing certain actions taken by her after the filing of the petition. According to Ms. Zelinka, she transferred a piece of artwork titled "Hare Castle" to you on July 20, 1999. The transfer was improper under Franklin Commercial Code §2-326 and §544 of the Bankruptcy Act.

The Trustee has elected to exercise his power under §549 of the Bankruptcy Act to avoid improper transfers made during the pendency of a bankruptcy case. Accordingly, demand is hereby made that you forthwith return to the Trustee the artwork titled "Hare Castle" or all proceeds from the sale thereof. If you fail to do so within 15 days of the date of this letter, the Trustee will commence legal action to recover the artwork or the proceeds.

Very truly yours,



Martin R. Feldner

LIBRARY

Walker On Bankruptcy (3d Ed. 1995)
A Short Course for the Non-Bankruptcy Lawyer

§4 - Definitions:

* * *

§4.07 - Chapter 11: A petition for a Chapter 11 “reorganization” commences a proceeding in which the insolvent debtor continues to operate as an ongoing business with certain restrictions. The business operates by the direction of the Bankruptcy Court under the management either of a court-appointed trustee or the debtor (debtor-in-possession). The Bankruptcy Act provides for an automatic stay of legal and self-help proceedings against the debtor pending the preparation and execution of a “plan of arrangement” pursuant to which the debtor “works out” its obligations to its creditors over an extended period of time.

§4.08 - Chapter 7: Often, Chapter 11 proceedings that fail are converted to Chapter 7 cases. A petition for bankruptcy under Chapter 7 commences a proceeding for liquidation of the debtor’s assets for the benefit of its creditors. A court-appointed trustee takes possession of the business, including all items in inventory, which thereafter come under the exclusive control of the trustee. The trustee is vested with all the rights possessed by the creditors of the bankrupt debtor prior to the filing of the petition. The trustee’s principal function is to marshal and, subject to the rights of secured creditors, sell the assets and distribute the proceeds proportionately to the creditors in accordance with their interests. Under §549 of the Bankruptcy Act, “the trustee may avoid a transfer of property of the estate . . . that occurs after commencement of the case”

* * *

§4.27 - Schedules of Assets, Debts, and Creditors: It is incumbent on the debtor in any bankruptcy proceeding to file with the court schedules of its assets, debts and creditors. All property, including goods delivered on consignment and accounts receivable, in which the debtor has any interest must be described and its location shown on the schedule of assets. Likewise, the amount of each debt and the name and address of the creditor to whom each debt is owed are required to be listed on the schedules of debts and creditors, with designations in each case as to whether the particular creditor is secured or unsecured. The schedules of secured creditors must describe with particularity the property of the debtor in which the creditor has a security interest.

Franklin Commercial Code

* * *

§2-326. Sale on Approval and Sale or Return; Consignment Sales and Rights of Creditors.

(1) Unless otherwise agreed, if delivered goods may be returned by the buyer even though they conform to the contract, the transaction is

- (a) a “sale on approval” if the goods are delivered primarily for use, and
- (b) a “sale or return” if the goods are delivered primarily for resale.

(2) Except as provided in subsection (3), goods held on approval are not subject to claims of the buyer’s creditors until acceptance; goods held on sale or return are subject to such claims while in the buyer’s possession.

(3) Where goods are delivered to a person for sale and such person maintains a place of business at which he deals in goods of the kind involved, under a name other than the name of the person making the delivery, then, with respect to claims of creditors of the person conducting the business, the goods are deemed to be on sale or return. The provisions of this subsection are applicable even though an agreement purports to reserve title to the person making delivery until payment or resale or uses such words as “on consignment” or “on memorandum.” However, this subsection is not applicable if the person making the delivery

- (a) complies with an applicable law providing for a consignor’s interest or the like to be evidenced by a sign, or
- (b) establishes that the person conducting the business is generally known by his creditors to be substantially engaged in selling goods of others, or
- (c) complies with the filing of provisions of the Article on Secured Transactions (Article 9), or
- (d) delivers goods which the person making delivery used or bought for personal, family, or household purposes.

* * *

Franklin Civil Code

§3533 - Sign Law.

If a person transacts business and identifies his place of business by a sign and fails by another sign or signs in letters easy to read and posted conspicuously in his place of business to state that he is dealing in property in which others have an interest and identifying such property, then all the property, stock of goods, money, and choses in action used or acquired in such business shall, as to the creditors of such person, be liable for his debts and be in all respects treated in favor of his creditors as his property unless the provisions of Franklin Commercial Code §2-326(3)(b) through (d) are applicable.

First National Bank v. Marigold Farms, Inc.

Franklin Court of Appeal (1997)

In this case, we determine the priority of the claims of First National Bank (the Bank) and Marigold Farms, Inc. (Marigold) to \$139,000 in a bank account (the Fund) of Pacific Wholesalers (Pacific). The trial court held that the Bank was entitled to the Fund. Marigold appeals.

The Bank had loaned \$600,000 to Pacific and Pacific, in turn, had executed a security agreement granting the Bank a security interest in certain assets of Pacific. The Bank had perfected its security interest by filing a financing statement with the Secretary of State. Pacific defaulted on the loan and the Bank sued. Pacific and the Bank negotiated a settlement pursuant to which cash received by Pacific in the conduct of its business would be delivered to the Bank and applied to the balance of the loan. Marigold asserted claims to the same cash and also asserted that its claims had priority over any claim of the Bank. The court approved the settlement subject to resolution of the competing claims of Marigold and the Bank and ordered \$139,000 of Pacific's cash receipts held in a "blocked" account (*i.e.*, the Fund).

The facts of the relationship between Marigold and Pacific are undisputed. Marigold was a grower of flowers. Pacific was a flower wholesaler. They had a longstanding relationship under which Marigold would deliver flowers to Pacific and obtain a delivery receipt. Pacific would mark the flowers with Marigold's name, package them, and attempt to sell them to retail florists at prices determined by Pacific. If the flowers were sold and Pacific received payment, Pacific would remit to Marigold 75% of the sale price, retaining 25% as its commission. If the flowers were not sold, Pacific would with Marigold's approval discard them, and Marigold would receive nothing for those flowers. It is also undisputed that the Bank had no actual knowledge of the nature of the commercial arrangement between Marigold and Pacific.

The Bank's financing statement and the security agreement between Pacific and the Bank describe the collateral as: "All inventory used in Pacific's business now owned or hereafter acquired; and all accounts and rights to payment of every kind now or hereafter arising in favor of Pacific out of Pacific's business, including all proceeds from the sale of inventory."

Under the Franklin Commercial Code, it is clear that, upon delivery of Marigold's flowers to Pacific, the flowers became part of Pacific's "inventory" because they were held by Pacific for sale. The Fund consists of "proceeds" of this inventory.

Marigold contends that its sale of flowers to Pacific was a “consignment sale,” that Pacific never had title to the flowers and that, therefore, Pacific never owned the collateral (inventory) to which the Bank’s security interest could attach. Marigold also asserts that Franklin Commercial Code §2-326(3) is inapplicable in this case.

A consignment sale is one in which the merchant takes possession of goods and holds them for sale with the obligation to pay the owner of the goods from the proceeds of the sale. If the merchant does not sell the goods, the merchant may return them to the owner (or, as in this case of perishable flowers, discard them) without obligation. In a consignment sale transaction, title to the goods generally remains with the original owner. The arrangement between Marigold and Pacific was a consignment sale arrangement; Marigold was the consignor and Pacific was the consignee. Under FCC §2-326(3), which clearly governs this transaction, the retention of title by Marigold is irrelevant to the ability of the Bank to obtain a security interest in the collateral.

Marigold does not contend that it complied with the filing requirement under the secured transactions division of the FCC as provided for in §2-326(3)(c). Nor does Marigold claim that it complied with an applicable “sign law” under §2-326(3)(a) or that it had delivered goods it had “used or bought for personal, family, or household purposes” as provided for in §2-326(3)(d).¹ Rather, Marigold claims that, as provided for in §2-326(3)(b), Pacific was generally known by its creditors “to be substantially engaged in selling goods of others.”

At the evidentiary hearing, Bank officials testified unequivocally that the Bank was unaware that Pacific was selling the goods of others. Three flower growers who also consigned flowers to Pacific testified that Pacific was “well-known as a commission selling agent” and that other flower growers knew it as well.

¹ The obvious reason for the exception for goods “used or bought for personal, family, or household purposes” is to avoid the situation where one who is not a merchant, and who should not therefore be deemed to know of the intricacies by which merchants protect their interests under the commercial code, unwittingly loses his right to property. If a householder occasionally delivers an item of property to a dealer to see if the dealer can sell it for him, the FCC protects that item from claims of the dealer’s creditors. On the other hand, if the deliverer is one who deals in goods of the kind sold by the person to whom he delivers the goods, he should be held to the rules in the FCC that bind merchants. There are hybrid situations such as, for example, where one collects gemstones for his personal use and enjoyment but also regularly places the gems on consignment with jewelers to test the market and sell if the price is right. At some point the casual collector crosses over the line from being the householder, whom the personal goods exception is designed to protect, to being a merchant or dealer, who is bound by the filing or other protective provisions of §2-326. In this case, Marigold is clearly at the extreme end of the merchant spectrum.

Although it is true that consignors, all of whom are necessarily also creditors, might know that Pacific deals in the goods of others, such knowledge cannot be extrapolated into a fact “generally known by its creditors.” The purpose of §2-326(3) is to protect general creditors of the consignee from claims of consignors who have undisclosed arrangements with the consignee. To impute as a matter of law the self-interested knowledge of the consignors/creditors to the general creditors does not give general creditors the opportunity to protect themselves from the undisclosed interests of the consignors.²

A consignor asserting that the consignee is “generally known by his creditors to be substantially engaged in selling the goods of others” must establish such general knowledge by proof other than that a few other consignors know that fact. He must establish that nonconsignor creditors possess the requisite knowledge. Marigold failed to meet that burden of proof.

Accordingly, we affirm.

² The result might be different if all or most of Pacific’s creditors were flower consignors, but that fact does not appear from the evidence in this case. If all or most of the creditors *were* consignors, then one might be able to conclude that the creditors did have such “general knowledge.”

In re Levy

Bankruptcy No. 29054

United States District Court, E.D. Pennsylvania (1993)

In December 1992, Bernard Levy, owner of a retail shoe store in Reading, Pennsylvania, filed a voluntary petition in bankruptcy. One of his suppliers, Acme Shoe Co. (Acme), had delivered a stock of shoes to Levy for resale in his store under the terms of a written agreement in which Levy, the bankrupt, acknowledged that the shoes were "on consignment" and could be returned to the consignor at any time.

Acme has filed a reclamation petition to recover the shoes it delivered to the bankrupt. The trustee resists the petition on the ground that the transaction was one of "sale or return," and, since there had been no compliance with §2-326(3) of the Pennsylvania Uniform Commercial Code, the stock of shoes while in Levy's possession was subject to the claims of Levy's creditors.

Acme concedes that it had not filed any financing statements in the public records offices. Acme did, however, produce evidence that small cards had been placed upon certain sections of shelving in Levy's store where Acme's shoes were stored and displayed, identifying the shoes placed on those sections of the shelving as shoes manufactured by Acme.

Under §2-326 of the UCC, if goods are delivered to a consignee primarily for resale with the understanding that they may be returned by the consignee, the transaction is one of "sale or return" and such goods are subject to the claims of the buyer's creditors while in the buyer's possession even though the consignor has retained title. The consignor may avoid the consequences of having the goods subjected to the claims of the consignee's creditors by doing one or more of three things: (a) complying with "an applicable law" evidencing a consignor's interest or the like by a sign to that effect, or (b) establishing that the consignee is generally known by his creditors to be substantially engaged in selling the goods of others, or (c) complying with the provisions for filing financing statements and other notice documents under UCC Article 9 having to do with secured transactions.

There was no filing under Article 9. There was an effort by Acme to protect its goods by posting signs on the sections of shelving where its shoes were kept, but Acme has failed to show that there is in Pennsylvania "an applicable [sign] law" as that term is used in §2-326(3)(a). The phrase "an applicable law" means a statute, and there is no such statute in Pennsylvania. Absent such a statute or an Article 9 filing, Acme is left with the burden of proving that Levy was generally known by his creditors to be substantially engaged in selling the goods of others.

Acme argues that, although the absence of a sign law might mean that the cards Acme caused to be placed on the shelves did not invoke the “sign law” subsection of §2-326, the cards nonetheless served to impart knowledge that Levy was selling the goods of others. That argument might have had some merit if Acme could have shown that the cards did in fact impart such knowledge to Levy’s creditors to such an extent that it was “generally known” by the creditors and that the cards also suggested that Levy was “substantially engaged” in selling goods not owned by him. On the record before the court, however, the most that can be said is that the cards were designed to impart to Levy’s *customers*, not his creditors, the knowledge that the shoes were Acme’s. Thus, Acme’s proof fell short.

Under §544 of the Bankruptcy Act, the trustee is vested with the rights that the creditors had prior to the filing of the petition in bankruptcy. Section 2-326(2) of the UCC expressly makes goods held on sale or return subject to the claims of the debtor’s creditors. That is the situation in this case.

Acme’s petition for reclamation is denied.