

**WARNING TO ST MARY'S STUDENTS:**

**THIS EXAMINATION WAS GIVEN IN A COURSE AT THE UNIVERSITY OF HAWAII AND IT COMBINES SALES AND SECURED TRANSACTIONS.**

Sales and Secured Transactions  
Professor Amy Kastely  
Examination, Spring 1993

Sales and Secured Transactions

1. This examination contains two essay questions. Please answer both. Question 1 asks you to identify the issues and arguments raised by the factual situation described. Question 2 asks for an answer divided into two parts: in Part 1 it asks you to evaluate the existing interests in a debtor's property and the priorities among them; Part 2 asks you to evaluate which interests, if any, may be avoided or reduced by a trustee in bankruptcy. Question 3 also includes two parts: two separate short questions. Please be sure to answer all parts of all questions.
2. The time and grading weight allocations among these questions are as follows:  
  
Question 1 – 70 minutes – 45% of the grade  
  
Question 2 – 70 minutes – 45% of the grade  
  
Question 3 – 20 minutes – 10% of the grade  
  
20 minutes are left for you to use as you see fit.
3. Please know that some issues raised by these questions are difficult; they cannot be resolved easily under the Uniform Commercial Code. Please do not be distressed by this; simply identify the issues and available arguments as you see them.
4. Please assume that the most recent version of the Uniform Commercial Code (that which we studied and discussed in class) governs the disputes set forth in this examination. If you are aware of a Hawaii variation on any relevant part of the Uniform Commercial Code please mention this as well.
5. Please plan your answers carefully. Your grade will reflect the clarity, conciseness, and organization of your answers as part of their substantive worth.

6. You may find it necessary to make assumptions, factual or otherwise, in your answers; if so, please state explicitly what assumptions you are making. Do not make any assumptions that are not consistent with the facts given.
7. This is a three-hour examination. All bluebooks must be turned in at the end of the three-hour period.
8. This is an "open book" examination. You may bring into the examination and use any written material. You may not consult with any person other than the proctor.
9. Please write your examination number and "Sales and Secured Transactions" on each bluebook that you use. If you type your answers, put this information at the top of each page. Please number consecutively each bluebook or typed page that you use.
10. Please begin a new bluebook or a new sheet of typing paper when you begin answering each question. Write on only one side of a bluebook page. Use the pages in between for later additions. If you type your answers, please double space and leave wide margins.

Thank you and good luck to you.

Question 1 70 minutes 45% of the grade

Henry Higgert owns a grove of macadamia trees on the Big Island. For fifteen years he has made money by growing and harvesting macadamia nuts that he sells to a company that processes and packages them. Last fall, Henry Higgert decided to expand his business to include shelling, chopping, and packaging the macadamia nuts that he grows. This expansion would enable him to sell chopped macadamia nuts (fit for home cooking use) to a national food distributor for a much higher price than he has received for unprocessed macadamia nuts.

Anticipating this expansion, Henry Higgert contacted Rose Lega, local representative of Indiana Farm Equipment Company. Rose Lega visited Henry Higgert's grove and talked with him about different kinds of equipment. She eventually recommended the Indiana 5000, a nut processing system that costs \$260,000, payable over 26 months. In describing the Indiana 5000, Rose Lega emphasized its speed and versatility (she said it is capable of processing a variety of different kinds of nuts).

After talking with Rose Lega, Henry Higgert met with a representative of Sunshine Farm Equipment. The Sunshine representative cautioned Henry Higgert that because of the extreme density of macadamia nut shells, most nut processing systems would leave too many shell pieces in the chopped macadamia nuts. The representative said that Sunshine could provide a specially designed system that would include two sifting machines, instead of the one included in most nut processing systems. The additional sifter would remove shell pieces after the chopping stage, just prior to packaging. The chopped nuts produced with this two-sifter system would contain no more than .01% of shell, while other systems would produced packages of chopped nuts containing as much as 2% shell. The cost of the two-sifter Sunshine system is \$320,000, payable over 24 months.

Henry Higgert met again with Rose Lega and told her he was concerned about the Indiana 5000's shell removal capabilities. Rose Lega told Henry Higgert that while no nut-processing system could remove all shell pieces, the Indiana 5000 would remove all but a very small portion (she said no more than 1% or so) and that the resulting chopped nuts would certainly be adequate for home cooking use.

Henry Higgert and Rose Lega (as agent for Indiana Farm Equipment) both signed a purchase agreement for the Indiana 5000 on December 1, 1992. The agreement included the following terms, among others:

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**Delivery:** F.O.B. Indiana Farm Equipment factory in Indianapolis, Indiana.

**Warranty:** Indiana Farm Equipment warrants that this equipment has no defective parts.

Indiana Farm Equipment promises that it will replace any part found to be defective if the buyer returns the equipment to the Indiana Farm Equipment factory in Indianapolis within 30 days of delivery to the buyer.

The remedy of replacement just described is the exclusive remedy available for breach of warranty.

This warranty is in lieu of all other warranties. **NO IMPLIED WARRANTIES SHALL APPLY.**

**Payments:** Henry Higgert will pay Indiana Farm Equipment a total of \$260,000, payable in 26 monthly payments of \$10,000 each, due the fifth day of each month.

Any failure to pay the monthly amount due under this contract will be an event of default, and Indiana Farm Equipment may then declare the entire amount of the purchase price then due.

**Security:** Henry Higgert hereby grants Indiana Farm Equipment a security interest in the Indiana 5000, to secure payment of the amount due under this contract.

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Indiana Farm Equipment did not file a financing statement regarding the Indiana 5000. Indiana Farm Equipment arranged for the equipment to be delivered to Henry Higgert's grove by railroad and ship and charged Henry Higgert for the costs of shipment. At some point after the equipment left Indiana, the equipment suffered water damage. The equipment arrived on February 1, 1993. Henry Higgert quickly installed the system in a building close to the groves and began processing macadamia nuts. He soon discovered that the water damage had caused corrosion in one of the engines. Henry Higgert paid a local mechanic \$7,000 to repair the damage. Henry Higgert did not have any insurance that would cover this expense, and the carriers have refused to compensate him for the damage.

After this repair, Henry Higgert was able to process macadamia nuts, but the product was disappointing. Each package of chopped nuts included approximately 2% shell slivers, enough so that the chopped nuts were unfit for home cooking use, although they could be used in the manufacture of macadamia nut extract.

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Henry Higgert asked the local mechanic to inspect the Indiana 5000. Having done this, the mechanic told Henry Higgert that the Indiana 5000 did not have any defective parts, it is just that it is not well suited for macadamia nuts.

Henry Higgert paid the monthly amount of \$10,000 for each of the first four months, from December to March. For his April payment he paid only \$3,000. With the payment Henry included the local mechanic's receipt and a letter explaining that Henry Higgert was subtracting the amount he had to pay for repairs to the Indiana 5000. In the letter Henry Higgert also wrote that the Indiana 5000 has been entirely inadequate for his needs and asked Indiana Farm Equipment to give him additional sifters that would make the system effective for macadamia nuts.

On April 29, five agents of Indiana Farm Equipment entered Henry Higgert's nut processing building in the middle of the night, by crawling through a window and then unlocking the front door. The agents dismantled the Indiana 5000, packed it into crates, loaded it onto a truck, and drove away.

When Henry Higgert went to the processing building in the morning, he thought he had been robbed. He called the police who inspected the area and wrote a report. Two weeks later, on May 14, Henry Higgert telephoned Rose Lega to tell her that the equipment had been stolen. She then told him that Indiana Farm Equipment had repossessed it. The next day, Saturday, May 15, Henry Higgert received notification from Indiana Farm Equipment that they were holding a public sale of the equipment in California on the following Monday, May 17.

The equipment was sold at the public sale for \$130,000. Indiana Farm Equipment then gave Henry Higgert notice that he owed \$87,000 (the alleged deficiency, which does not include any reduction for the \$7,000 repair cost) plus \$17,000 (for the costs of repossession and resale), for a total amount of \$104,000.

Henry Higgert does not think he ought to have to pay Indiana Farm Equipment \$104,000. Indeed, he is angry because he has lost at least three hundred pounds of macadamia nuts that are now unmarketable (because they were chopped with excessive amounts of shell by the Indiana 5000 equipment) and he has another thousand pounds from this growing season that he will have to sell at the unprocessed price of \$2.00 a pound rather than at the price for packaged chopped macadamia nuts, \$6.00 a pound.

Please identify the issues and arguments raised by this sorry situation.

Question 2 – 70 minutes – 45% of the grade

This question asks you to evaluate various interests in the property of Nadai, Inc. The question asks you first to evaluate the interests in existence on May 5, 1993. In a second part, it asks you to evaluate which interests, if any, can be avoided or reduced by the trustee in bankruptcy if Nadai had filed a petition for bankruptcy on May 5, 1993.

Nadai, Inc. ("Nadai") is a wholesaler of pottery. It is owned and operated by Nami Nadai. The business buys pottery from numerous producers located in Asia, the Pacific Islands, and the United States and sells to retail stores in Hawaii and California. Nami Nadai began the business in 1991. Nadai now has a central office and warehouse in a building in lower Kalihi where it maintains a substantial inventory of pottery. Throughout its history, Nami Nadai has acted as the authorized agent of Nadai.

On July 1, 1992, Nadai applied to the Federal Bank for a loan. During the following weeks, Nami Nadai met with officers of the bank to discuss various aspects of her business and plans. While these meetings continued, Nadai signed and Federal Bank filed (at the Bureau of Conveyances) a financing statement listing as collateral "all equipment now owned and hereafter acquired." This financing statement wrongly listed the company name as "Navai, Inc."

On August 1, 1992, Nadai entered into a supply contract with a small pottery manufacturing company on Kauai, called Kauai Crafters. The contract required Kauai Crafters to sell Nadai all of its output of pottery and Nadai to buy all of Kauai Crafters' output, at prices set forth in a price list that was attached to the contract document. In addition, the contract granted Kauai Crafters a security interest all the Kauai Crafters pottery, as security for any amounts owed by Nadai under the contract. Kauai Crafters took possession of the original contract document but did not file a financing statement.

On December 1, 1992, Nadai obtained a \$140,000 loan from Oahu Bank. Nadai signed a loan agreement in which Nadai promised to repay the loan in monthly payments over four years and granted Oahu Bank a security interest in "all inventory." The loan agreement also provided that Oahu may make future advances under the agreement. Nadai signed a financing statement that listed "pottery" as collateral. Oahu Bank promptly filed this financing statement at the Bureau of Conveyances.

On January 1, 1993, Nadai borrowed \$15,000 from a friend of Nami Nadai's, Joelle Henson, to use to pay the company's employees. At this time, in addition to Nami Nadai herself, the company employed a warehouse attendant and a purchasing agent. Nadai promised to repay the loan in one year and orally granted Joelle a security interest in a painting by the American artist Maxwell Mason, which is owned by Nadai and normally hangs in the office reception area. Nadai promptly delivered the painting to Joelle Henson; she hung it in her living room.

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On February 1, 1993, Federal Bank finally agreed to loan Nadai \$50,000. Both parties signed a security agreement granting the Bank a security interest in "all equipment, now owned or hereafter acquired." Federal Bank did not file a second financing statement.

On February 4, the value of all of Nadai's inventory of pottery other than the Kauai Crafters was \$60,000; the value of the Kauai Crafters' pottery was \$40,000. On the same day, the value of all of Nadai's equipment other than the Maxwell Mason painting was \$35,000. The value of the painting was \$15,000. On the same day, Nadai owed Kauai Crafters \$40,000; Oahu Bank \$136,000; Joelle Henson \$15,000; and Federal Bank \$50,000.

On March 1, 1993, Nadai entered into a purchase agreement with San Fernando Clay, a pottery manufacturing company in California, for the purchase of 300 pieces of hand-painted pottery. The contract price was \$30,000, and Nadai was obligated to pay the entire amount by June, 1993. On March 15, Nadai signed an agreement granting San Fernando Clay a security interest in this hand-painted pottery. On March 17, San Fernando sent a notice to Oahu Bank informing the bank about its delivery of pottery to Nadai. On March 19 San Fernando filed a financing statement at the Bureau of Conveyances in Honolulu. San Fernando delivered the hand-painted pottery to a delivery company on March 3 and arranged for delivery to Nadai, and it arrived at Nadai's warehouse on March 20.

On April 1, Mary Saito, the owner and operator of a retail store in Honolulu bought 50 pieces of the San Fernando Clay pottery from Nadai. In payment, Mary Saito gave Nadai \$8,000 in cash and a computer system (worth \$2,000). Nadai used all of the cash to buy a van that the company is using to deliver pottery.

On April 15, Nadai agreed to lease a small packing machine from Craig Williams for ten years at \$300 per month. According to the agreement, Nadai has an option to purchase the machine at the end of the ten years for \$10. The agreement also gives both parties the power to terminate the lease for any reason, provided that thirty days advance notice of termination is given to the other party. Craig Williams did not file a financing statement.

On May 5, the value of all of Nadai's inventory of pottery other than the Kauai Crafters pottery and the San Fernando Clay pottery was \$70,000; the value of the Kauai Crafters pottery was 60,000; the value of the San Fernando Clay pottery remaining in Nadai's inventory was \$30,000.

On the same day, May 5, 1993, the value of the computer was \$2,000; the value of the van was \$8,000; the value of the painting (still hanging in Joelle's living room) was \$15,000; and the value of the packing machine was \$30,000.

On the same day, the value of Nadai's equipment other than the computer, the van, the printing, and the packing machine was 45,000.

On the same day, May 5, 1993, Nadai debts were as follows:

- to Kauai Crafters: \$60,000
- to Oahu Bank: \$140,000
- to Federal Bank: \$50,000
- to Joelle Henson: \$15,000
- to San Fernando: \$30,000
- to various other creditors,  
all of whom were unsecured: \$25,000

Part 1:

Nadai asks you to evaluate the various interests in Nadai's property existing on May 5, 1993 and the priorities among them. [She is considering whether she may qualify for a new loan from a new or existing creditor].

Part 2:

Please assume, for the purposes of this Part 2 only, that Nadai filed a bankruptcy petition on May 5, 1993. Which of the interests that you identified in Part 1, if any, can be avoided or reduced by the trustee in bankruptcy?

Please assume that February 4 is 90 days before May 5.

Question 3 – 20 minutes – 10% of the grade

Part 1:

Jorge Julian is a collector of rare books. He has decided to sell some of his huge collection. He contacted the Long-Lost Letters, a used bookstore specializing in rare and out of print books. The owners of Long-Lost told Jorge Julian that they could not buy his books outright, because the store is having financial difficulties, but that they would be willing to set up a separate table in the store for Jorge Julian's books and to collect money from customers wanting to buy his books. Long Letters told Jorge Julian that it would charge him only \$500 a month for this arrangement. Title to each book would remain in Jorge Julian until it was sold to a customer.

Julian asks you if there are any hidden risks to him in this arrangement and whether there is anything he can do to reduce the risks. Please evaluate the proposed arrangement.

Part 2:

On March 25, 1993, Wilson Watanabe, a retail seller of shoes, entered into a contract with Fine Soles, a wholesale distributor of shoes, under which Wilson Watanabe would buy 500 pairs of hand-crafted sandals, at \$20,00 a pair to be delivered on June 1, 1993. On April 3, Wilson Watanabe paid Fine Soles \$5,000 as a downpayment.

On May 1, Wilson Watanabe heard rumors that Fine Soles was insolvent. Fine Soles apparently had been failing to pay its own creditors and had missed a few deliveries to customers during the past few weeks. Wilson Watanabe called Fine Soles and the owner told him that the rumors were true. The owner said that although Fine Soles it does have the 500 pairs of hand-crafted sandals in its warehouse, they would be sold to another buyer, who was willing to pay a higher price. Fine Soles told Wilson Watanabe that he should treat the contract as terminated.

Wilson Watanabe is troubled because he very much wants to get the 500 pairs of sandals themselves. He explains that although some hand-crafted sandals are on the market, most are not of as good quality as those sold by Fine Soles. Wilson Watanabe realizes that he may be able to sue Fine Soles for money damages, but he wants to know if there is any way that a court would order Fine Soles to give Watanabe the sandals themselves.

Please identify what grounds, if any, Wilson Watanabe may have upon which to make a claim for the sandals themselves.

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OF HAWAII AND IT COMBINES SALES AND SECURED TRANSACTIONS.

Commercial Transactions  
Professor Amy Kastely  
Examination, Fall 1991

Commercial Transactions

1. This examination contains five essay questions. Please answer all five. All of the questions ask you to discuss the issues and arguments raised by the factual situation described. The time and grading weight allocations among these questions are as follows:  
  
Question 1 – 30 minutes – 15% of the examination grade  
  
Question 2 – 20 minutes – 10% of the examination grade  
  
Questions 3, 4, and 5 – 40 minutes each – 25% of the examination grade for each.  
  
10 minutes are left for you to use as you see fit.
2. Please know that some issues raised by these questions are difficult; they cannot be resolved easily under the Uniform Commercial Code. Please do not be distressed by this.
3. Please assume that the most recent version of the Uniform Commercial Code (that which we studied and discussed in class) governs the disputes set forth in this examination. If you are aware of a Hawaii variation on any relevant part of the Uniform Commercial Code please mention this as well.
4. Please plan your answers carefully. Your grade will reflect the clarity, conciseness, and organization of your answers as part of their substantive worth.
5. You may find it necessary to make assumptions, factual or otherwise, in your answers; if so, please state explicitly what assumptions you are making. Do not make any assumptions that are not consistent with the facts given.

6. This is a three-hour examination. All bluebooks must be turned in at the end of the three-hour period.
7. This is an "open book" examination. You may bring into the examination and use any written material. You may not, however, consult with any person other than the proctor.
8. Please write your examination number and "Commercial Transactions" (or "Comm Trans") on each bluebook that you use. If you type your answers, put this information at the top of each page. Please number consecutively each bluebook or typed page that you use.
9. Please begin a new bluebook or a new sheet of typing paper when you begin answering each question. Write on only one side of a bluebook page. Use the pages in between for later additions. If you type your answers, please double space and leave wide margins.

Thank you and good luck to you.

Question 1 – 30 minutes – 15% of the examination grade

Academic Books, Inc. is a book publishing company located in Boston. In July of 1991, Hawaiian Booksellers, a retail store in Honolulu, ordered 400 copies of a new book by Saul Bellow entitled My Way and paid the full purchase price, \$4,000, in advance, as required by Academic Books. None of the communications between the parties made any mention of warranty.

The books arrived in Honolulu on August 15, 1991. Hawaiian Booksellers immediately realized that all of the books were missing pages 12 and 13. Accompanying the books were a stack of 400 loose papers entitled "Replacement Pages" that appeared to be the text from the missing pages 12 and 13. On August 25, Hawaiian Booksellers wrote to Academic Books, saying: "All of the books you sent are missing pages. We reject the shipment. What do you want us to do with your books?"

Academic Books did not respond to this letter. On September 15, Hawaiian Booksellers sold the 400 books to a recycling center for 10 cents each, receiving a total of \$40; the recycling center would pay nothing for the 400 "Replacement Pages." On September 16, Hawaiian wrote to Academic Books demanding a new shipment of non-defective books. Academic Books again did not respond.

Please assume that Hawaiian Booksellers has sought your legal service in this matter. As a first step in this work, please discuss the issues and arguments raised by this situation. Please include discussion of what remedies, if any, are available to Hawaiian Booksellers against Academic Books.

**Questions 2 to 4 involve Karl Hynes and his retirement project.**

Karl Hynes had been deeply touched when, in 1939, at the age of 19, he was given a personal picture album by his grandmother. The album contained pictures of Karl and his family taken at various times during his childhood. Upon retiring from his job as a frit salesman, Karl decided he would make personalized albums for each of his ten grandchildren.

But as Karl liked to tell his friends, he was never one to do things "half-way." Karl decided he would enlarge and annotate the pictures for his grandchildren's albums, and publish the ten books as volumes in a series entitled "The Heirs of Karl." And Karl decided he would do the whole production by himself in a "home publishing house" that he would construct in the spare bedroom. Sure it would be a lot of work, but family is important.

To foreshadow what will be told in greater detail below, things didn't work out very well for Karl. In fact he has been sued in three separate suits involving five companies and his children won't speak to him. His grandchildren are not all that happy with him either. With all of this litigation pending, Karl has had little time to work on the picture albums, and it seems now that they will never be completed.

These three questions focus on different suits now pending against Karl. Please imagine that Karl has come to your law office seeking legal representation. He has met with you and another lawyer in the firm and has told you the information set out in these questions. Now you and the other lawyer are thinking and writing about the disputes in which Hynes is involved.

**Question 2 -- 20 minutes -- 10% of the examination grade**  
**Nickerson Computers v. Karl Hynes**

Nickerson Computers, a retail computer store located in Seattle, Washington, claims that Karl telephoned its store on June 1, 1991 and orally agreed to buy one Superior Five Desktop Publishing Unit, at a price of \$12,000 F.O.B. Seattle, to be shipped by June 10, 1991. On June 11, Nickerson Computers shipped a Superior Five on International Airlines and it arrived in Honolulu later that night. Karl was named in the non-negotiable airline bill of lading as the consignee and so International Airlines notified him of the arrival of the computer on June 12. There have been no other communications between the parties. Karl refused to take possession of the computer from International Airlines and now denies ever having agreed to buy it.

The fair market value of the computer in Seattle is \$10,000. In New York the fair market value is \$8,000. In Honolulu the fair market value is \$13,000. The cost of shipping and insurance is \$600.

Please discuss the issues and arguments raised by this suit.

**Question 3 – 40 minutes – 25% of the examination grade**  
**Janet Computers v. Karl Hynes, with possible counterclaims.**

On June 2, Karl sent a letter to Janet Computers, a New York company that specializes in customized computer equipment. Karl had learned about Janet Computers from an advertisement in Computer Talk Magazine. The ad said that Janet computers offers "outstanding experts will design computer hardware and software to fit business needs." In his letter Karl inquired about the price of a customized computer with advanced desktop publishing capabilities. He explained that he wanted equipment that could enlarge and reproduce pictures that would appear on a page with text. Janet Computers responded by sending a "Price Quotation Form" that described a specially designed desktop publishing unit that would have greater and more flexible desktop publishing capacities than the Superior Five Desktop Publishing Unit about which Karl had spoken with Nickerson computers. The Price Quotation stated the price for this unit at "\$11,000 C.I.F. Honolulu" and indicated that one-half of the purchase price, or \$5,000 must be paid prior to shipment and the remaining \$5,500 must be paid within 30 days of delivery.

Karl immediately used his new Fax Machine to send a letter accepting Janet Computers' offer in all of its terms. On the next day, Karl sent Janet Computers a certified check for \$11,000. On June 23, Karl received an Acknowledgement Form from Janet Computers. Although Karl did not read the printing on the back of this document, it did include the following, which is in the same color ink and type size as the rest of the printing, except that this paragraph is in all capital letters:

**IF ANY OF OUR COMPUTER EQUIPMENT OR SOFTWARE SHOULD BE DEFECTIVE, WE WILL GLADLY REPAIR THE PRODUCT UPON ITS RETURN TO US. THE SELLER AND BUYER AGREE THAT THIS IS THE SOLE AND EXCLUSIVE REMEDY FOR A DEFECT IN THE COMPUTER EQUIPMENT OR SOFTWARE. THE SELLER WILL NOT BE BOUND BY ANY OTHER WARRANTIES, EXPRESS OR IMPLIED.**

The Janet Computers Desktop Publishing Unit arrived in Honolulu on June 25, packed in five boxes. Upon receiving the boxes, Karl noticed that two of them were water-damaged. Karl thought at the time that the contents might have been damaged during shipment, but once he had it set up in his spare bedroom, the equipment appeared to be in good condition and seemed to work well. Karl began using the desktop unit to write text for the first of the ten personalized albums.

Three weeks later, Karl was ready to add some pictures to the text. But after reading the manual for several hours, Karl realized that the Desktop Unit Janet Computers had sent him did not have the capacity to enlarge photographs as he had

planned. At least there was nothing in the manual that referred to such a function. Karl immediately wrote and faxed a short letter to Janet Computers:

**July 16, 1991**

**Dear Janet Computers:**

**I am appalled that you would send me a unit that won't do what it is supposed to do with pictures. I don't want the thing. I am sending it back to you tomorrow and I will expect you to refund my money immediately.**

**Sincerely,  
Karl Hynes**

That night the Desktop Publishing Unit was stolen from Karl's house. His insurance covers only \$1,000 of the entire value of the Unit. Karl has not paid the remaining \$5,500 of the purchase price.

Janet Computers has sued Karl for the remaining \$5,500.

**Please discuss the issues and arguments raised by this suit and by any possible counterclaim.**

**Question 4 – 40 minutes – 25% of the examination grade**

**Super Facsimile v. Karl Hynes, Frederick Finance, and Ramona Tanai Incorporated; with various counterclaims and cross-claims**

Karl decided that he needed a Fax (telephonic facsimile) machine so that he could correspond quickly with various companies and family members. After looking through numerous catalogues, Karl decided to buy a Super Deluxe High-Tone Facsimile Machine from Super Facsimile, a telephonic equipment distributing company located in Los Angeles. The catalogue price for the Super Deluxe High-Tone Facsimile Machine was \$2,000, with shipping costs to be paid by the buyer.

Karl sent a letter to Super Facsimile, asking them to ship him one Super Deluxe High-Tone Facsimile Machine as soon as possible. In response, Super Facsimile sent a detailed Acknowledgement Form that included a price of \$2,000, F.O.B. Los Angeles. The Acknowledgement Form indicated that the fax machine would be shipped under a non-negotiable bill of lading consigned as follows: "To High Tech Warehouse of Honolulu (account of Karl Hynes, tele: 238-3838)." Karl would be notified of the arrival of the machine and he would then be required to pay the \$2,000 to High Tech Warehouse upon receipt of the fax machine.

On May 14, Karl received a telephone call from International Airlines informing him that the shipment from Super Facsimile had arrived at Honolulu Airport. The International Airlines shipping agent had mistakenly assumed that Karl was an agent of the consignee, High Tech Warehouse. Karl went immediately to the airport and picked up the Facsimile package; he paid the airline freight costs, but he did not pay any of the \$2,000 purchase price.

On May 25, Karl decided he needed a loan to pay for paper and other supplies. Never one to support the banking establishment, he applied for a loan from Frederick Finance, a neighborhood loan company. Frederick Finance granted Karl a loan of \$1,500. In connection with this loan, Karl signed a written document that explicitly granted to Frederick Finance a security interest in the Super Deluxe High-Tone Facsimile Machine. Karl did not sign and Frederick Finance did not file a Financing Statement. Frederick Finance gave Karl a check for \$1,500 which he deposited in his regular checking account, along with funds from his retirement pension and from the Social Security Administration.

After trying the Super Deluxe High Tech Facsimile Machine a few times, Karl decided it was too complicated for his needs. He put an index card on the Student Bulletin Board at the Business School which said: "FAX MACHINE FOR SALE – DELUXE MODEL, USED ONLY A FEW TIMES. \$2,000 NEW, YOURS FOR \$1,500." The next day Ramona Tanai paid Karl \$1,500 in exchange for the Fax Machine.

Ramona Tanai is an Adjunct Professor at the Business School who owns and operates

her own accounting firm, Ramona Tanai Incorporated. Before giving Karl the money, Ramona asked Karl if there were any existing security interests or other claims on the Fax machine. Karl responded that he still owed money on the machine but that he did not think this would cause any problem for Ramona.

Karl still has not paid any money to Super Facsimile and he has defaulted on the loan from Frederick Finance. He has told both companies that the Machine has been sold to Ramona Tanai. In the litigation now pending, Super Facsimile has sued Karl and Ramona seeking possession of the Fax Machine. Frederick Finance has intervened in the action, asserting a right to the Fax Machine superior to all other claimants. Ramona Tanai has responded to these claims by claiming that of all three, she has the superior right to possession of the Fax Machine. Karl has denied any interest in the Fax Machine. At this point in the litigation, all parties have asked the court to determine who has superior right to possession of the Fax Machine. Please discuss the issues and arguments raised by these conflicting claims to possession of the Fax Machine.

Question 5 – 40 minutes – 25% if the examination grade

You have been hired by Simone Muling, President of the Mountain Finance Company, in connection with Mountain Finance's claims to various property now held by the Trustee in Bankruptcy of the Destiny Paving Company. Muling would like you to tell her the issues and arguments raised by these claims. She tells you the following:

On September 1, 1991, Mountain Finance lent \$250,000 to Destiny Paving. On that day both parties signed a written document in which Destiny Paving granted Mountain Finance a security interest in "all of the paving equipment, including steamrollers and other machinery, that Destiny now owns or may hereafter acquire, all of Destiny Paving's right to payment under any present or future paving contracts, and proceeds of such collateral." On that day Destiny Paving also signed the Financing Statement described below.

At the time of this agreement, Destiny Paving owned five steamrollers each worth \$50,000. Destiny Paving had no construction contracts or other substantial assets. This financial situation remained substantially the same for a few weeks.

On September 8, Mountain Finance filed the Financing Statement Destiny Paving had signed at the Hawaii state bureau of conveyances. The Financing Statement included the correct names and addresses of Mountain Finance and Destiny Paving and it listed the collateral as "paving equipment, paving contract rights, and proceeds."

On October 1, 1991, Destiny Paving traded one of the steamrollers for a cement mixer which was also worth \$50,000. On October 15, the paving business was very slow, without relief in sight, so Destiny Paving sold two of its remaining four steamrollers for \$100,000 and used the money from these sales to pay workers and rent. On November 1, Destiny Paving signed a contract with the Mokuna Resort and Golf course to pave a ten mile road and received a \$30,000 advance payment. On November 2, Destiny Paving used the \$30,000 to buy a new \$30,000 bulldozer.

On December 3, Kalani Bank, another creditor of Destiny Paving, filed an involuntary petition for bankruptcy against Destiny Paving, thereby commencing bankruptcy proceedings. A Trustee in Bankruptcy has been appointed.

Mountain Finance would like to recover the following items from the Bankrupt's (Destiny Paving's) estate:

- (1) the two remaining steamrollers
- (2) the cement mixer
- (3) the bulldozer.

The Trustee has objected to each of Mountain Finance's claims.

Please discuss the issues and arguments raised by the dispute between Mountain Finance and the Trustee regarding these items.

### Offer, Acceptance, Terms of Contract

M's letter to K constituted offer; K's letter to M constituted acceptance. Under UCC (which applies because this is transaction involving goods; even though construction of guitar may be service, M purchasing guitars, which are goods), mirror image rule doesn't apply. So K's letter is acceptance despite inclusion of additional terms. ✓

### Warranties

✓ M might argue story in MusiCrafts was express warranty. K would disagree. He didn't place ad. Express warranty requires affirmative conduct on seller's part. ✓

M might also say K's promise that guitars would be "joy to ears" was express warranty and guitar with flat tone was breach of warranty. K would say it was mere puffery, opinion; not assertion of fact. If it was express warranty, which it probably wasn't, would be difficult to disclaim. 2-316(1).

M would say K fits definition of merchant for purposes of 2-314 (merchant with respect to goods of that kind) so there was implied warranty of merchantability.

K would say contract contained effective disclaimer of that warranty. To exclude it, according to 2-316(2), language must mention merchantability and in case of writing be conspicuous. K specifically mentions merchantability. But disclaimer may not have been conspicuous enough. It wasn't in different color, larger font, etc. But K might argue that letter was so short, was necessarily conspicuous.

If such warranty isn't disclaimed, guitars must be fit for ordinary purpose and conform to any promise on package. M would say dull tone not fit for ordinary purpose.

Even if disclaimer effective M might argue it wasn't part of contract. Under 2-207(2), between merchants additional or different terms in expression of acceptance don't become part of contract if materially alter it. Disclaimer of warranty might be material alteration, so wouldn't be part of contract.

✓  
SM

### Risk of Loss

K breached duty to notify M of shipment, under both terms of contract and 2-504. However, 2-504© says failure to notify buyer of shipment is ground for rejection only if material delay or loss ensues. K would say no material delay or loss ensued.

✓

Furthermore, guitar not constructed properly was arguably breach of implied warranty of merchantability. This affects risk of loss during shipment

W

Normally, under shipment contract (K will argue this is shipment contract, because in absence of express statement that contract is destination contract, it's presumed to be shipment contract - 2-503, Comment 5) seller only needs to get goods to carrier, then buyer takes risk. So here, liability for 6 guitars damaged during shipment would fall on M.

✓  
Some

But according to 2-510(1) where delivery of goods so fails to conform to contract as to give right of rejection, risk of loss remains on seller until cure or acceptance. So as to dull-toned guitar, M would say K held risk of loss during shipment. But that guitar wasn't harmed during shipment.

✓  
/  
Some

## Shipment Costs

Under shipment contract, buyer pays shipping costs. So M owes K shipping costs.

*Oxley*

## Acceptance/Rejection of Goods, Buyer's Remedies

M will argue she rejected 7 guitars, in 2/3 telegram to K. K will say M accepted all guitars, and later tried to revoke acceptance of 7.

K will say rejection must occur within reasonable time after delivery. He will argue M failed to reject within reasonable time.

M will say buyers have right to inspect before acceptance. 2-513. Time to inspect may be after arrival of goods when seller is shipping goods to buyer.

K will say M had time to inspect goods after arrival, and she accepted them. 2-606 says acceptance occurs when buyer: a) after reasonable opportunity to inspect signifies to seller that goods are conforming; b) fails to make effective rejection after having reasonable opportunity to inspect; or c) does anything inconsistent with seller's ownership. K will say M made arrangements to have check sent to K; M sent no notice of rejection until 14 days after receipt of guitars; and M began displaying and selling guitars.

K has good argument – it looks like M accepted.

If M didn't accept, she may reject all or any commercial unit of goods because K failed to provide perfect tender – one guitar defectively constructed. M merely has to show goods failed to conform in any respect (2-601). Before acceptance, burden on K to show no defects.

Furthermore, under 2-711(3), M would have security interest in rejected goods, for any payment made.

But if M accepted, different remedies apply. Despite acceptance, M could sue for breach of warranty and recover difference between value of goods as warranted at time and place of acceptance, and value of goods as delivered (2-714), plus incidental and consequential damages (2-715). Assuming M provided proper notice under 2-607(3)(a) within reasonable time of discovery of breach. K may argue M failed to provide notice within reasonable time from which she should've discovered breach, and therefore she's barred from remedy.

Or, M may revoke acceptance. This is apparently what M wants to do, since she says she doesn't want guitars, only her money back. 2-608 says buyer may revoke acceptance of commercial unit whose nonconformity substantially impairs value to her if she's accepted it b) without discovery of such nonconformity, if acceptance reasonably induced either by difficulty of discovery before acceptance or by seller's assurances.

K will argue "defective" construction doesn't substantially impair value of unique guitar and/or M's acceptance wasn't reasonably induced by difficulty of discovery. After all, if she'd just tested it upon delivery, she would've discovered "defect." K will say M shouldn't be allowed to revoke acceptance.

If M allowed to revoke, she could get money back on dull-toned guitar. 2-711(3).

### **Right to Cure**

M may ~~not be able to~~ get money back on dull-toned guitar, even if she rejected or revoked acceptance.

K will argue he has right to cure. Under 2-508, where tender by seller is rejected because of nonconformity and time for performance hasn't yet expired seller may seasonably notify buyer of intent to cure and may then within contract time make conforming delivery. When K offered to repair guitars, M couldn't decline. K promised to deliver by 2/8 and it was only 2/4, so he has right to cure.

M might try to apply shaken faith doctrine, generally applicable only to automobiles. She could argue that defect has shaken her faith in guitar altogether, and she doesn't want seller to fix it - just wants her money back. She isn't likely to succeed with this argument.

M may run into another problem - her rejection/revocation of acceptance didn't state reason. Under 2-605(1), buyer's failure to state in connection with rejection particular defect ascertainable by reasonable inspection precludes her from relying on unstated defect to justify rejection or establish breach where seller could've cured defect if stated seasonably. K would argue defective construction could've been cured seasonably upon timely notification of defect, so now M can't rely on that defect in establishing breach by K.

### **Specific Performance**

M may argue specific performance available because handmade guitars are unique goods. 2-716. However, specific performance isn't common remedy under UCC, and she probably wouldn't win.

## Stolen Guitars

If M can prove guitars at UpScale are those stolen from her shop, she can get them back, even if UpScale was innocent purchaser. Because under 2-403(1), purchaser acquires whatever title transferor had power to transfer. Thieves have no title, so if thieves sold to reputable dealer who sold to UpScale, no title passed to either dealer or UpScale.

UpScale does have recourse against dealer, though. Under 2-607(5)(a) UpScale can give “vouching in” notice to dealer, which would bind dealer to judgment in case between M and UpScale. Even if dealer was also innocent purchaser, UpScale can recover for breach of implied warranty of title – state of mind is irrelevant to liability for breach of warranty.

If M fails to pay contract price for guitars when due K may recover price of stolen guitars under 2-709(1), because they’re conforming goods lost within commercially reasonable time after risk of loss passed to M. Of course, M may argue guitars weren’t stolen within commercially reasonable time after risk of loss passed to her. K and M likely to disagree over when loss of risk passed to M.

M may try to use 2-510(2) to escape liability for stolen guitars. 2-510(2) says where buyer rightfully revokes acceptance he may to extent of deficiency in insurance coverage treat risk of loss as having rested on seller from beginning. But stolen guitars were conforming goods, not ones whose acceptance M tried to revoke.

### **Seller's Remedies**

Since it's been 14 days since delivery, M has breached duty to pay. If M continues to refuse to pay, K can choose between 2 remedies of sellers for rejected goods. 2-708. K can recover difference between resale and contract price, plus incidental damages, or K can recover difference between market price at time and place of tender and contract price, plus incidental damages.

K may argue he's lost volume seller – he could've sold other guitars to resale purchaser, so damages provided in 2-708(1) insufficient. If K wins this argument he can recover profit he would've made from sale to M. 2-708(2).

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exhibit