

## Creditors' Rights Sample Exam

### Ethics Question

(Suggested Time - One-Half Hour)

You represent Bank, which has a duly perfected security interest in the inventory and accounts receivable of Debtor Inc. Debtor Inc. has not asserted any challenge to the perfection of your security interest, but has not been willing to acknowledge that this interest is unavoidable. You, as counsel for Bank, are not aware of any facts that would support an avoidance claim of Bank's interest. A Trustee has been appointed in Debtor Inc.'s case and is in the process of liquidating assets. The Trustee has refused to give Bank relief from stay and asserts that the Bank is fully secured.

The Trustee has initiated multiple preference actions against various trade creditors. The local rules require local counsel to represent any corporation in Bankruptcy Court. Your firm has been contacted by several preference defendants to represent them on the preference actions that have been brought against them. Each of the actions was brought as a separate adversary proceeding, and all are unrelated to each other.

Discuss the issues. What can you do? Be sure to identify the state where you practice and indicate, if you know, whether the ethical rules in your jurisdiction are patterned after the ABA Model Code of Professional Responsibility (usually numbered as "DR 2-105," etc.), the ABA Model Rules of Professional Conduct (usually numbered as "Rule 7.4," etc.), or neither.

### SAMPLE ANSWER

**A lawyer should exercise independent professional judgment on behalf of a client. This means that the lawyer must weigh carefully the possibility that his judgment may be impaired or his loyalty divided if he accepts or continues employment of multiple clients. He should resolve all doubts against the propriety of the representation and should not represent in litigation multiple clients with different interests if that would adversely affect the representation. If the interests vary only slightly and he can retain his independent judgment on behalf of each client, the client must be given the opportunity to evaluate his need for representation free from potential conflict and obtain other counsel if the client so desires. Thus, the attorney must make full disclosure to the clients and obtain their consent to the multiple representation. It would also be important for the attorney to consider the disruptive effect that withdrawal might have if the potential conflicts of interest become actual conflicts.**

**In this case there are two potential conflicts. Conflicts between the Bank and the unsecured preference creditors and conflicts among the preference creditors themselves. There always exists a conflict between a secured creditor and an unsecured creditor. In this case, even though the security interest of Bank appears to be uncontested, it has not been determined to be valid and thus is subject to attack by other creditors. Additionally, the value of the collateral has yet to be determined and the parties may have different interests as to how the property would be sold. Thus, it would be problematic for a firm to represent both an unsecured and a secured creditor**

unless all issues regarding the security interests and the value of its collateral have been previously determined. In regards to the conflict among the trade creditors, it is likely that these interests would be very similar, although the goal of each creditor is to maximize the preference recovery of the other creditors and minimize the preference recovery of that creditor. Once the amount of the claims is determined, however, the interests would be identical. Whether you could represent more than one defendant in a preference action would be determined on a case-by-case basis. Important factors would be:

1. The amount of the preference claim in relation to the other potential clients; and
2. The common defenses that the parties may have.

If the amounts are relatively equal and the defenses are the same, then it is likely that the attorney would be able to represent each without impairing his independent professional judgment. A practical problem exists in small communities where there may be more claims than attorneys. In such instances, competent local counsel may be very difficult to find unless local attorneys represent multiple clients.

### Creditors' Rights Substantive Question

#### Sample Question 1

Collection Issues

(allotted time 45 min.)

**NOTE:** The Creditors' Rights Substantive Essays are open book. A Bankruptcy Code will be provided to you. You may bring other sources that you deem appropriate including the Uniform Commercial Code, the Federal Rules of Civil Procedure, the Fair Debt Collection Practices Act and the Uniform Enforcement of Judgments Act. You may also use a calculator for the exam, although the math computations on the exam are basic.

A collection attorney, representing Largo Industries, obtained a judgment against Fred, who is *pro se*, in the amount of \$55,000 for breach of contract. Shortly after the judgment was entered, Largo's counsel called Fred at 10:00 pm and threatened to contact his employer if Fred didn't make payment arrangements. Fred said, "Call me at a reasonable time," and hung up the phone. A week later, Largo's counsel called Fred at 10:00 pm again, used profanity in referring to him, and demanded payment. Fred repeated his request to be called at a reasonable time and hung up the phone. Two days later, Fred received a letter in the mail, from Largo's attorney and addressed to him which stated, "You owe our client \$55,000 for a judgment entered against you by a judge in this county. Please contact us immediately to make payment arrangements or we will have no choice but to exercise our client's post-judgment remedies."

Fred was so fed up that he called Largo's counsel and offered to pay \$1,000 per month (for 55 months) in full settlement of the judgment. Largo's attorney wanted a voluntary wage garnishment, but Fred said that he would have to pay by check because his employer would fire him if he had a wage garnishment.

Critique the actions of Largo's counsel and Fred's response to the request for a wage deduction.

**Answer:**

**The attorney's behavior is regulated by the Fair Debt Collection Practices Act (15 U.S.C. Section 1692 *et seq.*). It prohibits debt collectors (which includes attorneys) from harassing a consumer. One form of harassment is to engage a person in telephone conversation repeatedly with intent to annoy, abuse or harass any person at the called number. Another form is the use of obscene or profane language. In addition, it is also a violation of the Act to communicate with a consumer in connection with the collection of a debt at any unusual time or place, with the statutory assumption that a reasonable time is between 8:00am and 9:00pm. Largo's counsel violated all the aforementioned provisions of the Act and may be subject to penalties provided for therein.**

**Fred's response about his employer firing him over a wage garnishment may not have been entirely accurate. The Consumer Credit Protection Act (15 U.S.C. Section 1601 *et seq.*) provides in Section 1674(a) that "No employer may discharge any employee by reason of the fact that his earnings have been subject to garnishment for any one indebtedness. If this wage garnishment is Fred's only one, this Act prohibits the employer for discharging him for the reason Fred fears.**

### **Creditors' Rights Substantive Question**

#### **Sample Question 2:**

UCC Article 9

(allotted time 45 min.)

Bethany's Bread Emporium's test kitchen is in desperate need of new baking equipment. President Bethany Yeast approached her long-time bank, Southern Trust, for an additional \$50,000 loan. Bethany's Bread currently owes Southern Trust \$250,000, and Southern Trust, as of two years ago, has a security interest in all of Bethany Bread Emporium's now owned and thereafter acquired equipment (which was properly filed). Southern Trust refused any further advance. Ms. Yeast then approached Owen's Oven Supply, who agreed to provide financing for part the purchase price of \$50,000 (at an attractive rate) -- provided a down payment of 10% is made. Not having the \$5,000 down payment, Ms. Yeast approached Northern Trust for a \$5,000 loan -- and they agreed, provided that their loan is secured with the new baking equipment. Northern Trust filed its financing statement describing the baking equipment on March 1 of this year. Ms. Yeast purchased the baking equipment on March 10 and Owen's Oven Supply filed its financing statement on the same day.

Who has priority with respect to the new baking equipment -- Southern Trust, Northern Trust or Owen's Oven Supply?

**ANSWER: Southern Bank is the original, non Purchase Money Security Interest Lender. Southern Bank was first to file. Northern Trust lent Debtor the money for**

**the down payment, and filed second. Northern is a pmsi lender. Owen's Oven Supply is also a pmsi lender and seller – and it filed third.**

**The rules that governs this priority contest are found in Revised 9-324(a) & (g). A purchase money security interest has priority over a non-purchase money security interest. ( § 9-324(a)) If more than one security interest qualifies for pmsi priority in the same collateral, and if one party has a seller pmsi and the other is a lender (the provider of an enabling loan) then the seller's pmsi has priority. Both Northern Trust and Owen's Ovens would have priority over Southern Trust's security interest in the new baking equipment, but because Owen's Oven Supply has a seller pmsi, it would have priority over Northern Trust's security interest.**