California
Bar
Examination

Performance Tests
And
Selected Answers

July 2011

PERFORMANCE TESTS AND SELECTED ANSWERS

JULY 2011 CALIFORNIA BAR EXAMINATION

This publication contains two performance test from the July 2011 California Bar Examination and two selected answers to each test.

The answers received good grades and were written by applicants who passed the examination. The answers were produced as submitted, except that minor corrections in spelling and punctuation were made for ease in reading. The answers are reproduced here with the consent of the authors.

Contents

I. Performance Test A

II. Selected Answers

III. Performance Test B

IV. Selected Answers

July 2011

California
Bar
Examination

Performance Test A
INSTRUCTIONS AND FILE

IN RE BRENT QUILLEN

Instructions………………………………………………………………………………. 5

FILE

Memorandum from Allan Zackler to Applicant……………………………………… 6

Transcript of Interview with Brent Quillen…………………………………………… 7

Memorandum from Barnett Graves to Allan Zackler……………………………….. 12

Letter from Lance Templar to Brent Quillen………………………………………… 15

Promissory Note……………………………………………………………………….. 16

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 Quillen

Guarantor

July 2011

California
Bar
Examination

Performance Test A

LIBRARY

IN RE BRENT QUILLEN

LIBRARY

Walker on Negotiable Instruments…………………………………………………. 20

Excerpts from Columbia Commercial Code………………………………………. 22

Venaglia v. Kropinak (Columbia Court of Appeal, 2005)……………..……………. 25

Melandris v. Richter (Columbia Supreme Court, 2007)………………..…………… 30

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 note. The Bank immediately took possession of the Corporation's unsold inventory of

[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.

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.

Answer 1 to Performance Test - A

Pavlik, Griego & Zackler
Attorneys-at-Law
Interoffice Memorandum

Date: July 26, 2011
To: Allan Zackler
From: Applicant
Subject: in re Brent Quillen - issues raised by Quillen interview/documents

Mr. Zackler,

Below is an analysis of the questions you requested stemming from your interview with Mr. Quillen and his questions as to his rights and obligations. Per your instructions, I organized the analysis in the order of the questions as you explained them to Mr. Quillen at the conclusion of your interview. They are answered in the order they were presented to Mr. Quillen. For your convenience, I have summarized the answer to each question briefly (without citations or authority) at the beginning of each response. That summary is followed by an explanation which is cited to the appropriate authority for your review, to help you prepare for your follow-up meeting next Monday. The explanations are subheaded at certain points for your convenience.

1. Can Mr. Quillen get reimbursement from Mr. Phillips?

Answer:

Mr. Quillen's (hereafter Q's) ability to recover from Mr. Phillips (hereafter P) depends on a determination by the court of whether or not Mr. Phillips signed the promissory note as a "maker" or as a "guarantor." If Mr. Phillips signed the note as a maker, Mr. Quillen is entitled to reimbursement on the note from Mr. Phillips. If Mr. Phillips signed the note as a guarantor, Mr. Quillen is not entitled to recovery against Mr. Phillips. The determination of the capacity in which Mr. Phillips signed the note is made by the court, according to the factors discussed below.

Explanation:

The Columbia Commercial Code (hereafter "CCC") deals with the rights and obligations of parties who enter into agreements in the form of negotiable instruments, as well as what effect the form of the instrument or the signature of the parties affects their rights. CCC 3149(a) explains the roles of two parties in interests that are signed for accommodation. According to the code, a party who signs an agreement intending to incur liability on the instrument without being a direct beneficiary of the value given for the instrument, the instrument is signed "for accommodation" by that party. As you discussed with Q, the rights and obligations of a party differ depending on whether or not they sign a note as an accommodation (or "as a favor to") a third party, or whether they are themselves the primary beneficiary of the interest being granted (called "the accommodated party.")

Those particular obligations are spelled out in CCC 3149(e), which specifically describes that an accommodation party who pays the instrument is entitled to reimbursement from the accommodated party and can enforce the instrument against the accommodated party. Practically speaking, this means that if Q is an accommodation party and P is an accommodated party, then Q has a right to reimbursement from P.

Q's status as an accommodation party

First, Q will have to establish under the CCC that he is, in fact, an accommodation party. As you correctly informed Q during your interview, a guarantor is an example of an accommodation party. Specifically, we can be confident that Q is a guarantor because of the provisions of CCC 3419(c), which states that "a person signing an instrument is presumed to be an accommodation party.if the signature is.accompanied by words indicating that the signer is acting as a surety or guarantor with respect to the obligation of another party to the instrument." This language, coupled with the language of 3419(a) described above, establishes that Q was acting as a guarantor. Case law supports this conclusion, as the Columbia Court of Appeal decided in *Venaglia v. Kropinak* (2005) that a plaintiff who signed a Promissory Note as a guarantor for the primary benefit of allowing a corporation to enter into a contract with a lender met the definition of an "accommodation party." Further, it appears from Q's statements to you that First Franklin wanted Q to sign because of his success in business and the presence of his substantial assets. Finally, as discussed in *Venaglia*, a plaintiff meets the presumption of 3419(c) if his/her signature appears under the heading "GUARANTOR." Here, Q's signature does in fact appear with the word "guarantor" next to it on the signed note. All the evidence points towards a court finding that Q is an accommodation party. The only evidence to the contrary is P's vague statement that Q might get some stock if Intercon Inc ever went public, but since Q never believed this would occur, and because Q signed as a guarantor, Q will be considered an accommodation party.

<u>P's status under the note</u>

The more complicated question is whether or not P will be considered an accommodation party like Q, or whether he will be considered an accommodated party. As discussed above, this determination will have a profound impact on Q's ability to collect from P. If P is a "maker" or "accommodated party," then Q is entitled to reimbursement from P. If P is an accommodation party, Q is not entitled to any reimbursement.

The Columbia Supreme Court addressed this question in *Melandris v. Richter* in 2007. *Melandris* involved a plaintiff who sought reimbursement from defendant under a similar arrangement to the note signed by P and Q. The plaintiff's contention in that case was essentially that because the defendant had not signed the note as a guarantor - his signature was accompanied by no words indicating that he was a surety or a guarantor - he must have necessarily been a "maker" under the note. (*Melandris*) The court rejected this position, holding that sort of "inverse reading" as "flawed." Nor does the position of the signature on the document constitute a determining factor. Q cannot assert that just because P signed on the front of the document where a maker would sign, he is per se a maker. As noted by the court in *Melandris*, "nor is it determinative of [plaintiff's] status that he signed the note as a maker." (*Melandris* citing 3419(c)). Instead, the Columbia Supreme Court adopted the test articulated by the Olympia Supreme Court in *First National Bank v. Rafoth*, making that test mandatory authority in our state. The *First National* test involves five factors, with factors iv. and v. identified by our Supreme Court as likely the more influential factors. The five factors as applied to our case are discussed below:

i. Corporate capacity/ownership of the signer

Like the defendant in *Melandris*, here P is the Chief Executive Officer of Intercon, Inc, the undisputed beneficiary of the proceeds of the note. This factor supports a finding that the note was for the benefit of P personally, but it is not determinative.

ii. Location of the signature on the note

Again, like the defendant in *Melandris*, here P signed the note on the front, near the bottom, where a maker would typically sign. This factor also supports the conclusion that P benefited personally as an accommodated party, but it is also not determinative. It should be noted that the above factors were also met in *Melandris*, where the case was remanded for further fact-finding as to the following factors.

iii. Language used in conjunction with the signature

Here, P signed the note as "an individual." It appears that, whether to avoid liability or whether out of a good-faith belief that he was an accommodation party, P believed that his signature with the phrase "an individual" indicated that he was not the principal beneficiary of the loan but merely an accommodation party. Without more information about P's intent and the bank's understanding of this modifying phrase, it is difficult to conclude what the legal effect of the word will be. However, the presence of language that differentiates P as "an individual" appears to be some evidence that he signed the note in an accommodation capacity. In *Melandris*, no adjective accompanied the signature.

iv. Whether the signer received the loan proceeds

Here, we have more information than the court had in *Melandris*, and we may be able to forecast the result. As to your interview with Q, you learned that P was "pretty honest and scrupulous" about making sure that all the money went towards the company's operating expenses, that he may have gotten an "indirect" benefit from the money by taking a salary, and that he drew only a small salary from the company. We also have Mr. Graves' findings from his research into the bankruptcy proceedings. Those indicate that P received a modest ($1,500 per month) salary from Intercon only when the company made a profit, that the only use of loan funds by Phillips was to pay wages and salaries to employees and operating expenses, and that the company leased him a car for his personal use. Aside from the use of a personal car, all of the expenses seem to be directly for the benefit of Intercon, except for the marginal value of the personal use of the car.

The Melandris court made no observations about the effects of certain facts under CCC 3419(a) as they related to the fourth factor. However, from the language of the statute itself, we can glean some insight as to how P's use of the money will be viewed by the court. First, 3419(a) states that if a party signs an instrument for the purpose of incurring liability "without being a direct beneficiary of the value given," he/she is signing the instrument as an accommodation party. As further explained by Professor Walker's treatise, the "key inquiry" is whether and to what extent [a party] received a direct benefit from the proceeds of the loan." It appears from the information we have before us that P did not receive a direct benefit from the proceeds of a loan, but that instead the loan proceeds were primarily to the benefit of Intercon. Even totaling the $18,000 in unpaid wages claimed by P in his bankruptcy proceeding and the total value of the car and the salary he drew, the resulting number represents a small fraction of the $3,000,000 extension of capital on behalf of First National to Intercon and P.

v. Intent of the parties

The intent of the parties as to whether P signed the note as a maker or as a guarantor is the final factor of the *Melandris* opinion as adopted from the Olympia Court's *First*

National opinion. The court in *Melandris* had no information with which to discern this intent, so we are left with a case of "first impression" in our state as to the meaning of factor *v.* From P's perspective at the time the note was signed, it appears that he intended to sign the note to escape personal liability as a maker. As evidenced by what Q recounted as "language [P] wouldn't normally use," it appears he viewed himself as not personally benefiting from the note because, as he said at the time, he does not get any "direct benefit" from the loan. We will need more information to determine whether P had a good faith belief that he was not a "maker" or whether he was, as Q suspects, reciting language from his attorney to escape liability.

However, we can discern something about the intent of *First Franklin* from your conversation with Q and from their actions after they sought payment of the note. First, Q indicated that they suggested to P that Q co-sign on the note and request that P sign as an individual. Their knowledge of Q's assets suggests that they considered you a guarantor, and also by implication that they did not place much value in P as a guarantor personally for the note. If P were really signing as an "accommodation" to himself as a corporation, it did not have much practical effect on First Franklin's willingness to enter into the arrangement. This suggests that First Franklin considered the note to be for the benefit of P and considered Q the sole surety. Further, there is no evidence that First Franklin sought repayment from P personally on the note. This is not determinative by itself - *Melandris* makes clear that a bank "may pursue one or the other [of accommodation parties] at its option" - but it is some evidence that First National considered P a "maker" under the original note and not an accommodating party. We also have a statement from First Franklin in its bankruptcy filing distinguishing P as "cosigner" and Q as "indorser." Again, this is inconclusive, but may be some evidence that First Franklin did not consider P an "indorser" or an accommodation party by virtue of its use of distinct terms to describe P and Q.

Based on a review of all five factors, it cannot be determined with certainty how a Columbia Court will view the status of P under this arrangement. It is applicant's suggestion that you advise Q that he may not be entitled to recovery from P, depending on whether or not the Court views P as an "accommodating party." The factors seem to lean slightly in favor of finding P an accommodating party, based on his use of the money for entirely corporate purposes. Because *Melandris* does not express an opinion of the Columbia Supreme Court as to whether or not factor iv. or v. is the more influential factor, it would be best to counsel Q that recovery is uncertain, and advise him of the facts we need to prove each factor.

Steps for Q to obtain recovery

If the court does find that P is an accommodated party, then Q must first pay his obligation under the note. That amount is likely, as discussed below, to be offset by the amount that FF impaired the financial interest it had in Intercon's equipment. However much Q is responsible for paying, satisfying his obligation as an indorser is a prerequisite to recovering from P as an accommodated party. As *Melandris* makes clear, the indorser is unquestionably obligated to the bank for the balance due on a note. However, if P is an accommodated party, Q can thereafter seek contribution from him for reimbursement.

2. Can Mr. Phillips obtain any recovery from Mr. Quillen?

Answer:

No. P is not entitled to recovery from Q. No matter whether P is determined an accommodation party or an accommodated party, he cannot recover from Q. If he is an accommodated party, Q is entitled to reimbursement from P. If he is an accommodation party, Columbia law makes clear that accommodating parties are not jointly and severally liable, so P cannot recover from Q.

Explanation:

Fortunately for Q, the resolution of the answer to question 1 does not affect P's right to recover from Q. No matter whether the court decides he is an accommodation party or an accommodated party, he cannot recover from Q.

If P is an accommodated party

If P is considered an accommodated party (or a "maker" under the note) the statutory effect is clear. CCC 3419(e) states that "an accommodated party who pays the instrument has no right of recourse against, and is not entitled to contribution from, an accommodation party." Citing this section, *Melandris* confronted this issue and reached the same conclusion - that an accommodated party has no entitlement to contribution from an accommodation party.

If P is an accommodation party

Assuming the court reaches the opposite conclusion and that P is considered a "guarantor" like Q, he still has no right of recovery against Q. *Melandris* decided this question. The court held that the obligations of two parties who are both accommodation parties was separate and several, not joint and several. As explained by the Court, "[t]he Code makes provision for contribution only among parties jointly and severally liable on an instrument, but not otherwise. Thus, if both [parties] are accommodation parties, they are not jointly and severally liable and therefore *will not be as between themselves entitled to contribution from one another*." (emphasis added) In our case, if P and Q are considered accommodation parties, they are only severally liable for the obligation on the original note. As discussed in more detail below, the bank can choose between them as to seeking its recovery, but that party cannot recover from the other accommodation party.

3. Does First Franklin's apparent loss of its security interest in the equipment and inventory reduce any obligation of Mr. Quillen, and, if so, to what extent?

Yes. The CCC protects the obligations of indorsers to the extent that collateral could have been used to recover some of the debt owed by the maker of the note. In this case, First Franklin (FF) did not timely file a continuation statement to the state, causing the interest in the equipment and inventory of Intercon to be seized by another creditor. The CCC identifies lapse as an example of failing to protect an interest. From the bankruptcy statements, it appears Q's obligation will be reduced by $1,200,000.

Explanation:

Section 3605 of the CCC establishes the rights of an accommodation party to discharge from a debt owed based on any secured interest possessed by the lender. Specifically, 3605(e) states that to the extent an obligation held by the person entitled to enforce an instrument is impaired by that party, the obligation of an indorser is discharged to the extent of the impairment. Practically speaking, this means that if Q can show that FF allowed the value of a security interest to be impaired, Q's duty to pay is discharged by that amount. 3605(g) lists some examples of how a party can "impair" an interest, including 1. failure to maintain perfection or recordation of an interest in collateral, 2. release of collateral without substitution, 3. failure to perform a duty to preserve the value of collateral owed to a surety, and 4. failure to comply with applicable law in disposing of collateral. The official comment to 3605 describes the obligation as such: "the surety is discharged to the extent the surety proves the impairment was caused by a person entitled to enforce the instrument."

In our case, FF filed a financing statement in March of 2002. According to CCC 9515, a "filed financing statement is effective for a period of five years after the date of filing." A filing is termed to "lapse" if a continuation statement is not filed sometime before the end of the five year period. Thus, FF should have filed a continuation statement sometime before March of 2007. However, as the bankruptcy records make clear, they did not. Mr. Graves found there were no continuation statements on file. The FF interest lapsed in March of 2007. The consequences of lapse are described in section 9515(b): "Upon lapse, a financing statement ceased to be effective and any security interest that was perfected by the financing statement becomes unperfected." The statute goes on to describe that the interest is deemed never to be effective against a purchaser of the collateral for value.

The consequences for FF and Q are as follows: First, CCC 3605(g)(1) specifically lists "failure to obtain or maintain perfection or recordation of the interest in collateral" as an example of impairing the value of interest in collateral. Second, CCC 9515(b) holds that a subsequent taker of an interest in an unperfected security interest takes free of any effect that the original financing statement might have had. In other words, Columbia National Bank's interest against the inventory takes priority to FF's. Based on these facts, FF has failed to maintain the value of the interest it had in the inventory and equipment of Intercon. The bankruptcy filings indicate that the equipment and inventory had a net worth of $1,200,000 - $800,000 as to the equipment, and $400,000 as to the inventory. As the Columbia Supreme Court recognized in *Melandris*, CCC sections 3605 e and g provide for discharge of an indorser to the extent that the secured creditor fails to perform a duty to preserve the value of the collateral. By allowing the interest in the equipment and inventory to lapse, FF failed to protect their interest, and their ability to collect from Q will be discharged to the amount of the interest.

4. Does First Franklin's release of Mr. Phillips act as a release of Mr. Quillen to any extent?

Answer:

No. Both case law and statutory law make clear that an accommodation party should expect to be pursued for the amount of debt it agrees to secure without regard for how much the lender is able to secure from the maker. The relationship between maker and indorser is such that a bank can recover as much as it determines possible from the maker, and it may pursue the indorser for the balance.

Explanation:

Q's statements in your interview with him make clear that he is somewhat vexed about the ability of bank to "pick and choose" who they want their money from, especially because they are pursuing $2,000,000 from Q after obtaining only $1,000,000 from P. Unfortunately for Q, the Columbia Court of Appeal addressed this question and fully explained the rights of makers and indorsers, and they include the right of the lender to reach a settlement with the maker and pursue the indorser for the balance.

In *Venaglia v. Kropinak*, the Court of Appeal of our state confronted a case where a defendant claimed that when a settlement leaves a maker without assets, the defendant should not be required to pay the balance of the amount owed, because the lender has taken all of the assets from the maker, such that it is impossible for the indorser to recover anything in contribution from the maker. Put more simply, if a settlement reduces the assets of the maker to zero, the defendant in *Venaglia* argued that the lender has destroyed his ability to recover in violation of 3605(b), and so he should not have to pay the amount owed.

However, the Court of Appeal rejected this argument, and in doing so fully explained the extent of a right of recourse of a promisee (or, the lender). Although the defendant in *Venaglia* characterized his "right to recovery" against the plaintiff as a "worthless right," the court held that the label was inappropriate in the context of 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." (*Venaglia*) In that case, the lender "should be able to collect everything possible from the accommodated party and then proceed against the accommodation party." The court further observed that "[c]ollecting from the accommodated party can often be facilitated by the promisee's release of the accommodated party in return for [that] party paying what it can." Further, the accommodation party should have no complaints, because "it knew that the promisee would look to it if the accommodated party encountered financial difficulty."

In our case, this language resolves the question of FF's ability to pick and choose from whom it attempts to collect. Even if Q asserts that his right of recovery as an accommodation party is a worthless right, because our bankruptcy information indicates that "it is very doubtful that there will be any appreciable distribution to unsecured creditors," Q still has the "right" to recover from Intercon. As discussed by the *Venaglia* court above, this right is not "worthless" because Q, as an indorser, should have realized that FF would perhaps release P's corporation from its obligations in order to obtain what money it could. In our case, that money paid to FF- like the *Venaglia* settlement - is the entirety of Intercon's remaining assets.

However, as the *Venaglia* court noted, that is the very purpose of having an accommodation party sign the form to begin with. FF wanted Q to sign the note precisely because it was afraid that P or P's corporation would be unable to pay everything that it owes. Q, then, just like the defendant in *Venaglia*, should not be surprised when FF reaches a settlement agreement with Intercon in order to facilitate paying off the amount owed. In accommodation relationships such as the one Q entered into, it is expected that the promisee will reach a settlement agreement with the maker, and then - because an indorsement gives the lender this right - proceed for the balance against the accommodation party. Q's status as accommodation party makes him responsible for the remaining debt, because FF's freedom to pick and choose is contemplated by the form of the original agreement. To paraphrase from *Venaglia*, Q should have known that FF would look to Q if P's corporation encountered financial difficulty. As *Venaglia* concludes, "the accommodation party should expect to be obligated to pay to the extent that the accommodated party does not have the resources to pay."

The statutory language supports this conclusion as well. Section 3604(a) states that a person entitled to enforce an instrument, with or without consideration, may discharge the obligation of a party to pay the instrument by agreeing not to sue or otherwise renouncing rights against the party. Further, in the introduction to the CCC by Professor Walker, he defines "Indorser" as a person who signs the note on the back - as Q did - and who undertakes to pay the note according to its terms if the maker does not. The use of a settlement to facilitate payment from Intercon to FF does not relieve Q of liability on the note.

Although it may frustrate Q, he is responsible for the amount owed, and the settlement does not act as a release.

Answer 2 to Performance Test - A

Date: July 26, 2011

To: Allan Zackler

From: Applicant

Subject: In re Brent Quillen

This is the memorandum you asked me to write referring to Quillen's rights and obligations on the promissory note he signed for InterCon and Mark Phillips. To answer your first question, I have concluded that Quillen is an accommodation party under the note. This means that he can receive reimbursement from Mark Phillips if Mark is found to be an accommodated party, rather than another accommodation party. However, the court could apply one of two tests to determine Mark's status under the note, which would affect Quillen's ability to collect from him; therefore this may be a close issue, but I believe a court would find Mark to be an accommodated party rather than an accommodation party. In regard to the second question, Mark will not be able to receive any reimbursement from Quillen for his $1 million payment on the note, regardless of whether the court finds him to be an accommodation party or an accommodated party. Third, First Franklin's mishandling of the security interest in the inventory and equipment will reduce the amount Quillen owes on the note by $1.2 million. Fourth and finally, the discharge of Mark will have no effect to discharge Quillen's obligations as an indorser of the note.

1. Can Quillen receive reimbursement from Mark Phillips?

Whether or not Quillen can receive a reimbursement from Phillips turns on their status in regards to the promissory note, whether either or both are accommodation parties or accommodated parties. An accommodation party is one who signs an instrument without being a direct beneficiary of the loan. An accommodated party, on the other hand, is the party who receives the value of the instrument. Walker on Negotiables; CCC 3419.

Quillen's status

An accommodation party is a party who signs the promissory note instrument for accommodation. CCC Section 3419. This means that this party signed the instrument without being a direct beneficiary of the loan or value given for the instrument. Id. Generally one who signs on the back of the instrument is an accommodation indorser. Walker on Negotiable Instruments. In *Venaglia*, the court found that when a party signs a note as a guarantor, and the purpose of the note is to benefit another party, and when the party who signed is not a direct beneficiary of the transaction, this presumptively showed under section 3419a that the party was an accommodation party.

Here, Quillen signed the note on the back, thus giving rise to the presumption that he is an accommodation indorser. Walker. Moreover, Quillen signed the note and received no consideration for his signing the note. See interview. In fact, Quillen stated that he signed the note only as a personal favor to his sister and brother in law. Id. The note was also for the purpose of helping Mark and his corporation, InterCon, and conveyed no direct benefit to Quillen. Finally, Quillen signed the note as a guarantor. Therefore, this meets the definition under CCC 3419a of an accommodation party and accords with the *Venaglia* court's interpretation of an accommodation party.

Moreover, CCC 3419(c) states that a person signing an instrument will be presumed to be an accommodation party if the signature is an anomalous indorsement or accompanied by words indicating that the party is acting as a guarantor.

Here, Quillen signed the note as a "guarantor," which would be sufficient to give rise to the presumption that he is an accommodation party. The other fact giving rise to a presumption, of an anomalous signature, will likely not apply to Quillen. The court in

Melandris, in a footnote, explained that a signature is anomalous if it takes place outside of the chain of negotiation. Quillen's interview, however, stated that his indorsement was a vital part of securing the loan as First Franklin would not give Mark the loan without another security. However, because Quillen signed on the back as a guarantor and received no direct benefit from the note and signed instead as a favor, he will likely be deemed an accommodation party.

Quillen's obligations and rights regarding payment and reimbursement

An accommodation party who is an indorser has certain obligations. If the instrument is dishonored, an indorser becomes obligated to pay the amount due on the instrument. CCC Section 3415. Even though an accommodation party does not receive consideration, this does not relieve him of his obligations to pay.

However, an accommodation party can receive reimbursement and is in fact entitled to reimbursement from the accommodated party to the instrument. Thus, it must be determined whether Mark is an accommodation party or an accommodated party to determine whether Quillen has a right to reimbursement.

Mark's status

One who signs on the face of the note is a maker. Walker on Negotiable Instruments. However, a maker can be construed as a principal obligor or an accommodation maker. If a party is a principal obligor, this means he receives the benefit of the loan, and it is for his benefit that an accommodation party signs the loan. Id. Thus a principal obligor is an accommodated party. However, a maker can also be an accommodation maker, which means he did not receive the benefit of the loan and is merely accommodating the principal maker. There are several ways to determine whether a maker is a principal obligor or an accommodation maker.

Test from Walker on Negotiable Instruments:

Walker on Negotiable Instruments provides that the key inquiry to determine whether a party is a maker or an accommodation party is to what extent that party received a direct benefit from the proceeds of the loan. Here, the interview with Quillen shows that Mark himself did not receive much of a direct benefit. He did not take much more than a minimal salary, and in fact the bankruptcy court has a claim from him for $18,000 in unpaid salary. Most of the loan went toward operating expenses of the corporation and the only benefit Mark received was the use of a car.

However, the initial negotiations for the loan were as a personal loan to Mark for his patent. The corporation of InterCon was only formed during negotiations for this loan. This fact could be used to show that Mark did directly benefit from the loan because it allowed him to form a corporation for his patent. However, because InterCon is a separate entity and was the principal obligor on this transaction, the main borrower in this loan transaction, it is primarily liable and it will be deemed to have received the most direct benefit. This may be a good argument, however, as the facts of this case as distinct from a normal transaction where a CEO signs for his company, as the loan was given so that Mark could form this company, so that his capacity in signing the note could be construed differently.

Test from *Melandris*

The Columbia Supreme Court in *Melandris*, however, has provided another test to use to determine whether a party who signed as a maker was or was not an accommodation party. This five factor test comes from the Olympia Supreme Court case *First National Bank v. Rafoth*. Under this test, to determine whether one who signed as a maker was or was not an accommodation party, the court needs to examine a series of factors. These include: 1) the corporate capacity/ownership of the signer; 2) the location of the signature on the note; 3) the language used in conjunction with the signature; 4) whether the signer received the loan proceeds; and 5) the intent of the parties.

In *Melandris*, the court in dicta explained that the last two factors, 4 and 5, would likely be the most influential ones.

Here, under the first factor, Mark was the CEO of the corporation and therefore this factor would go in favor of him being the principal obligor. Moreover, as stated above, this case is slightly different from *Melandris* in that Mark signed the loan so that he could start his corporation. This could be distinguishable from *Melandris* where the party who signed was the CEO and President could have been viewed to have a greater disconnect between himself and the company's obligations.

Second, Mark signed the note on the face or the front of the note. This suggests, according to the court, that he is a non-surety maker, meaning he would more likely be construed as a maker and not an accommodation party.

Third, the language used in conjunction with the signature here was that of Mark as "an individual." In *Melandris*, one party argued that because the signature did not have accompanying words that suggested the party signed as "surety" or "guarantor," that the absence of these words implied that the party was an accommodated party and not an accommodation party. Here, we could make the same argument and assert that because Mark's signature does not explicitly state he is a guarantor or other similar language, that this could tend to imply he is a principal obligor. However, as the court stated in *Melandris,* this would not be a dispositive factor. But this would swing in our favor in conjunction with the other factors.

Fourth, it is not clear exactly how much of the proceeds Mark received and therefore how much of a benefit he received from the loan directly. As stated above, we could argue that because the loan was originally for Mark and it was only suggested he form a corporation in order to better secure the loan, that he alone truly received the benefit of this loan. However, Mark will argue that he did not receive any direct benefit because he took very little salary and spent most of the loan toward operating costs of the corporation. This will likely be sufficient to show that Mark did not receive enough benefit from the loan to be construed as a principal maker. But, as I stated above, we could argue that these facts are distinguishable from a normal situation where the corporation secures a loan and the CEO signs as well because of Mark's personal interest in starting the corporation. It is important that we gather as many facts on this issue as possible as it is likely a future court would weigh this factor heavily.

Fifth, the intent of Quillen in entering this transaction was to do a favor for Mark personally, and not for the corporation. In *Melandris*, the accommodation party was principally signing as a favor to the corporation. In our situation, however, we could argue that Quillen had no previous business relationship with the corporation, and only signed with the intent to benefit Mark. Moreover, Mark likely viewed the loan as a benefit to him personally as it allowed him to begin his commercial venture and pursue his patent. The bank in this case, First Franklin, began negotiations with Mark as an individual and only later suggested that he form a corporation to better secure the loan. This could show an intent that the bank did not wish to give the loan to Mark personally and intended the loan to go his corporation, which would go against our argument that the intent was to benefit Mark alone. Moreover, Barnett Graves's research uncovered First Franklin's amended claim, wherein it refers to InterCon and Mark Phillips as principals under the loan, but then goes on to refer to Mark as a cosigner. This first statement shows First Franklin's intent under the loan that Mark would be a principal obligor and not an accommodation party. But, the next reference to him as a cosigner tends toward the view that it believed him to be an accommodation party instead. Again, this is a factor the court would likely weigh heavily, and could be dispositive of this issue. We could argue that the first reference should be used to show its intent, and that the second reference was First Franklin using its language imprecisely and did not imply that Mark was an indorser or an accommodation party, but only that he also signed the loan as a principal.

Overall, under this test, it could be reasonably be argued that Mark was a principal obligor and not an accommodation party and I believe we could prevail in this showing that Mark was actually an accommodated party and not an accommodation party.

Quillen's rights against Mark if Mark is an accommodation party

If the court determines that Mark is in fact an accommodation party, based on the fact that he arguably did not receive a direct benefit, then Quillen would have no right to recover from Mark. According to *Melandris*, an accommodation party is independently liable on the note, and the liability of accommodation parties is separate and several and not joint and several. This means that the bank, or whoever is enforcing the obligation, has the option to choose from whom it will collect and neither party would have the right of reimbursement from the other. Therefore, if Mark is an accommodation party, then First Franklin would have the right to recover as much as it wants from Mark and then move to recover from the other accommodation party, and Quillen would have no recourse against Mark.

Quillen's rights against Mark if Mark is an accommodated party

If we can succeed in proving that Mark is in fact an accommodated party, an outcome that would be much more beneficial to our client, then Quillen will have the right to reimbursement. An accommodation party who pays for a note is entitled to receive reimbursement from the accommodated party. CCC 3419(e).

In conclusion on this issue, if we can succeed in showing that Mark, when he signed as an individual, was signing as a principal obligor maker and not as an accommodation maker, then Quillen will be entitled to recover whatever he pays on the note from Mark.

2. Can Mark Phillips recover anything from Quillen?

Once more, Mark's rights against Quillen turn on the definition of the parties. As analyzed above, Quillen is likely and almost assuredly an accommodation party because he received no benefit under the loan, signed as an indorser, and signed the back of the note.

By knowing with certainty that Quillen is an accommodation party, we can know with certainty Mark's rights against Quillen.

An accommodated party under the loan never has an entitlement to contribution from an accommodating party nor has any recourse against an accommodation party. Melandris; CCC section 3419(e). Here, if Mark is an accommodated party, he would have no right to recover from Quillen any contribution from Mark's payment on the note.

An accommodation party similarly has no rights against another accommodation party. As analyzed above, an accommodation party has separate liability and not joint liability, according to the Columbia Supreme Court in *Melandris*. This liability is separate and several rather than joint and several, so that neither is entitled to contribution from the other, but the bank may pursue either for its claim.

Therefore, regardless of Mark's status as an accommodation or accommodated party, he would not be able to personally receive any contribution from Quillen for his $1,000,000 payment on the note.

3. Does First Franklin's loss of security interest reduce any obligation Quillen has, and if so, to what extent?

When an obligation is secured by collateral and a person entitled to enforce the obligation impairs the value of the interest in collateral, the obligation of an accommodation party is discharged to the extent of this impairment. CCC Section 3605(e). This discharge will occur when the creditor who is entitled to enforce the note fails to perform a duty to preserve the value of the collateral. CCC 3605(e). This principle was exemplified in *Melandris*. There, the bank who had the right to enforce the note had a security interest in the form of the corporation's inventory. However, the bank mismanaged and destroyed the value of this collateral while collecting the loan. The court found that because the bank failed to protect the inventory from destruction, this breach of duty discharged the amount due to the extent of the impairment of the security interest.

Here, First Franklin had a valid security interest in InterCon's equipment and inventory. Therefore, if it is found to have breached a duty and impaired the value of that security interest, then Quillen's obligations would be reduced by that amount.

In this case, we could argue that because First Franklin lost the security interest to another bank, the amount of that loss should reduce the amount Quillen would owe. Here, First Franklin failed to maintain perfection and recordation of the security interest in the collateral. This is given as an explicit example of a failure to preserve the value of collateral in CCC section 3605 (g), which would give rise to a decrease in obligation of an accommodation party.

The Columbia Code explains that a financing statement is only effective for a period of five years. If the statement is not continued with a continuation statement, it will lapse. This lapse causes the security interest to become unperfected. CCC Section 9515.

Here, after an investigation by Barnett Graves, we were able to look at First Franklin's filings under the commercial code. First Franklin did file its financing statement that documented its security interest in the equipment and inventory of InterCon in 2002, when the note was first given. However, a little more than five years later, Columbia National Bank filed a financing statement expressing a security interest in the same equipment and inventory. There is no indication that First Franklin filed any continuation statement, as required under the CCC to maintain a perfect security interest. Therefore, First Franklin is at fault in the loss of this security interest.

Graves also was able to uncover the amount of the security interest based on Columbia National Bank's bankruptcy proceedings. There, the equipment and inventory were found to have a total value of approximately $1.2 million. Here, First Franklin is requesting $2 million from Quillen. If the value of the security interest (the equipment and inventory) had been deemed greater than the amount of obligation Quillen owed, then his obligation would have been totally discharged. However, because it is less than the remaining amount on the note, Quillen could still be obligated to pay at least $800,000, or the remaining balance due on the $3 million note after Mark's payment of $1 million and the decrease from the value of the lost security interest of $1.2 million.

4. Does First Franklin's release of Mark have any effect to release Quillen?

CCC Section 3605 provides that the discharge of the obligation of a party to pay a note does not discharge the obligation of an indorser or accommodation party. CCC Section 3605(b). The Columbia Court of Appeal echoed this sentiment in the *Venaglia* case. There, the party who had indorsed the note argued that by discharging the principal obligor of his obligation and taking its property that could have relieved the indorser of his liability, that this in effect should discharge his obligation as an accommodation party. The court, however, rejected this defense and found that the release of the principal did not release the accommodation party of his obligation, and that the accommodation party still had his right to seek reimbursement from the principal, even if that right was effectively worthless because the principal had no assets.

Here, Quillen would like to argue that by releasing Mark from his obligations, he should also be discharged from his obligations because the release of InterCon and Mark left little if any estate from which Quillen could recover, thereby effectively taking away his right of contribution. See Graves' memo on First Franklin's bankruptcy claim. However, it appears that this argument has no merit. The *Venaglia* case specifically states that the discharge of the obligor has no effect to discharge the accommodation party. It goes on to reason that this would defeat the purpose of having an indorser on a note, if that indorser's obligations would be discharged as soon as the obligor could no longer pay, when in fact the point of the indorser is to have someone there to pay the note if the principal obligor cannot.

Here, First Franklin was entitled to take what it could from InterCon and from Mark, and then go after Quillen for the rest. If Mark is found to be an accommodated party, Quillen will still have his rights to seek reimbursement from Mark and from InterCon. Even if this right turns out to be worthless because of the potential insolvency of Mark and InterCon, his right is still intact. Therefore, a court would not release Quillen just based on the fact that Mark was released.

Furthermore, in the *Melandris* decision, the court stated that the bank has the right to collect from either accommodation party in order to collect the full amount. Therefore, even if Mark is found to be an accommodation party rather than an accommodated party, his release still would have no effect on Quillen as the bank is free to pursue either until it collects the full amount due.

Therefore, Quillen would still be liable and First Franklin can still collect from him based on his status as an accommodation party, but Quillen will still be able to seek reimbursement from Mark (if Mark is an accommodated party) regardless of Mark's release.

I hope that this helps in your meeting with Quillen. Please let me know if I can provide further assistance in this matter.

July 2011

California
Bar
Examination

Performance Test B
INSTRUCTIONS AND FILE

DAVID v. SOVEREIGN AUTO STORE, INC.

Instructions.. 61

FILE

Memorandum from Martin Snider to Applicant.. 62

Memorandum Regarding Persuasive Briefs and Memoranda.......................... 63

Memo to File: Notes from Interview with Joe David...................................... 65

Complaint.. 67

Letter from Paula Burke to Martin Snider.. 71

Purchase Agreement for Used Car... 73

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.
6. The File contains factual materials about your case. The first document is a memorandum containing the instructions for the tasks you are to complete.
7. 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

<u>Notes from interview with Joe David, May 30, 2011</u>

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. SOVEREIGN AUTO STORE, INC., Defendant	)	Civil Case No. 2011-12073 **COMPLAINT**

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:	**$21,106.50**

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)….. 77

Fillman v. Cornado Homes, Inc. (State of Columbia, Court of Appeal, 2001)………. 82

Marshall v. Fermby (Supreme Court of Columbia, 1981)……………………………... 86

Selected Provisions of Unfair Trade Practices Act……………………….………… 90

Selected Provisions of Columbia Arbitration Act…………………….………………. 92

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.[3] 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?

[3] 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.

Answer 1 to Performance Test – B

IN THE SUPERIOR COURT OF BRYANT

CIVIL DIVISION

Joe David,	)	
Plaintiff	)	
	)	Civil Case No. 2011-12073
v.	)	
	)	
Sovereign Auto Store, Inc.,	)	
Defendant	)	
______________________	)	

PLAINTIFF'S MEMORANDUM OF POINTS AND AUTHORITIES IN OPPOSITION TO DEFENDANT'S MOTION TO COMPEL ARBITRATION

STATEMENT OF FACTS

Plaintiff Joe David (Mr. David) has brought suit against Defendant Sovereign Auto Store (SAS), alleging unlawful trade practices in violation of the Unfair Trade Practices Act as well as fraudulent misrepresentation, in connection with the July 28, 2009 purchase of a used car. Mr. David is a 25 year-old single father of three children - aged one, three and eleven - who drives a school bus to make a living. In July 2009, his car was having mechanical problems. After it wouldn't start, he decided to head to SAS to look for a new car. Upon arriving at the dealership, he was greeted by a saleswoman, "Ann." He informed the saleswoman that the most he could afford for a new car was $200 a month. She examined his paystubs, and told him that he was qualified for a loan of $389 a month. Mr. David repeated that he could only afford $200 a month, but the saleswoman insisted that he should look at what he could receive at a higher price. Ann led Mr. David to a used 2005 Mazda Tribune, which had a blue book value of $9,775 at the time. After taking it for a test drive, Ann brought Mr. David the papers to sign to purchase the car. Ann informed Mr. David that he had to sign the paper in order to buy the car. There was no negotiation over the price, which was $19,995. Mr. David signed the contract, obligating him to pay $389 for 72 months. Between September 2009 and July 2010, he made the payments regularly. He fell behind for one month from July to November 2010. Finally, he was unable to make regular payments after November 2010, because his doctor advised him to cease working temporarily due to a health issue. SAS repossessed the car in December 2010, sold it at auction for $6,125, and subsequently demanded payment of $13,368.95 in a letter dated May 15, 2011. Mr. David filed suit against SAS on July 8, 2011. SAS subsequently filed a motion to compel arbitration, requesting that this court enforce the arbitration provision located in paragraph 4 of the agreement between Mr. David and SAS.

ARGUMENT

The Supreme Court of Columbia, in Medina v. Core Healthcare Services (2000), articulated a comprehensive framework for determining when agreements to arbitrate are enforceable. When the agreement seeks to compel arbitration of "statutory rights" that "serve important public purposes," such agreements must, at a minimum, "provide for: (1) neutral arbitrators; (2) all types of relief available in court; and (3) must not require [parties] to pay arbitrator's fees or expenses that make a forum inaccessible." In addition all arbitration agreements - including those that do not involve statutory rights that serve important public purpose - are unenforceable if they are unconscionable.

The arbitration agreement at issue fails under almost every part of the Medina test. The arbitration agreement requires arbitration of rights that serve important public purposes, but does not provide all relief that is available in court, requires Mr. David to pay fees and expenses that make the arbitral forum inaccessible, and is unconscionable. While it does provide for neutral arbitrators, because Mr. David must consent to the selection of the arbitrator, the agreements failing on every other portion of the Medina test renders it unenforceable. As a result, this court should rescind the arbitration agreement.

I. The Arbitration Provision Of The Purchase Agreement Between Mr. David And SAS Is Unenforceable Because It Violates Public Policy By Limiting The Available Remedies Guaranteed By The Unfair Trade Practices Act, Including Treble Damages, Attorney's Fees, Punitive Damages, And Injunctive Relief.

A. The Claims Advanced In Mr. David's Complaint Encompasses Unwaivable Statutory Rights That Serve An Important Public Purpose, Because They Are Designed To Protect The Public From Deceptive Commercial Practices.

The Columbia Arbitration Act provides that "[a]n 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 inequity for the revocation of the contract." Columbia Arbitration Act (CAA) § 26(a). The Columbia Supreme Court has clarified that in agreeing to arbitrate a statutory claim, litigants do not forgo their substantive rights, but rather only submit them to resolution through arbitration. Medina v. Core Healthcare Services (2000). As a result, agreements that "compel claimants to forfeit certain statutory rights are unenforceable." Medina. Specifically, where arbitration agreements encompass "unwaivable" statutory rights are at issue they are subject to "great scrutiny." This is so for two reasons. First, contracts exempting anyone from responsibility for "fraud" or for a violation of law are against public policy. Medina. Second, statutory rights that "serve important public purposes" may not be waived via an arbitration agreement. If the statute provides unwaivable rights, there are "three minimum requirements" for the enforceability of such an arbitration agreement - the agreement must "provide for: (1) neutral arbitrators; (2) all types of relief available in court; and (3) must not require [parties] to pay arbitrator's fees or expenses that make a forum inaccessible." Medina

Here, Mr. David's complaint asserts an unwaivable statutory right, designed to prevent fraud, that is serves an important public interest. As a result, the arbitration agreement must meet the three requirements outlined in Medina or it is unenforceable.

First, Mr. David's complaint raises a claim designed to prevent parties from engaging in fraud. The first cause of action contained in Mr. David's complaint arises under the Unfair Trade Practices Act (UTPA). This Act makes it unlawful for any person to "fail to state a material fact if such failure tends to mislead" or to "make or enforce unconscionable terms or provisions of sales of leases." UTPA § 4(b)-(c). As a result, the UTPA clearly is designed to protect consumers from fraud, subjecting it to the three-prong test created by Medina.

Second, Mr. David's statutory remedy is unwaivable. In the remedies section, the Act provides that "[t]he remedies provided in this section may not be waived." UTPA § 7(a). While this section by its terms applies only to the remedy, rather than the underlying right, it clearly indicates the importance of the UTPA remedies to consumers, and thus strongly indicates that the UTPA should be construed as an unwaivable statutory right. This is particularly so given that the UTPA is to be "construed and applied liberally to promote its purposes" of consumer protect. UTPA § 1(b).

Third, Mr. David's claim advances an important public interest. The UTPA provides that its purposes including promoting, "through effective enforcement, fair business practices throughout the community," and assuring that a "just mechanism exists to remedy all improper trade practices and deter the continuing use of such practices." UTPA § 1(a)(2)-(3). Like the Columbia Fair Employment Act (CFEA) at issue in Medina, the UTPA is designed to ensure protection of important public rights. The Medina court explained that the CFEA's prohibition on discrimination in connection with employment "inures to the benefit of the public, nor just a particular employer or employee." Similarly, the UTPA, as is explained in the purposes provision, is designed to ensure that consumers are not subject to unfair and deceptive trade practices. Allowing Mr. David to pursue his claim will not simply benefit Mr. David, but will help to deter future conduct on the part of those transacting with consumers, and will help ensure fair business practices. As a result, Mr. David's claim advances an important public interest.

In sum, then, the rights protected by the UTPA are equivalent to those advanced in Medina, such that the three-pronged Medina test ought to apply. As a result, if the agreement does not provide for neutral arbitrators and all types of relief available in court, or if the agreement does require the parties to pay arbitrators fees that render a forum inaccessible, the agreement is invalid.

B. Because The Claims Advanced In Mr. David's Complaint Encompass Unwaivable Statutory Rights That Serve An Important Public Purpose, The Limitation of Remedies Required By The Arbitration Provision of The Purchase Agreement Renders It Unenforceable.

"An arbitration agreement may not limit statutory imposed remedies such as punitive damages and attorney fees." Medina. Here, the arbitration agreement limits a wide variety of remedies guaranteed by the UTPA.

The UTPA provides for six separate remedies, which may not be waived: (1) treble damages, or $ 1,500 per violation, which is greater, (2) reasonable attorney's fees, (3) punitive damages, (4) an injunction against the use of the unlawful trade practices, (5) additional relief in representative actions and (6) any other relief which the court deems proper. UTPA § 7(c).

The arbitration agreement, by contrast, provides only a limited set of remedies for Mr. David. First, it provides 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 losses as determined in the sole discretion of the arbitrator." Second, it provides that the arbitrator may "order that the losing party pay the prevailing party's costs."

The relief in the agreement does not provide close to matching that of the statute. Damages are limited to the total amount paid by the purchaser, which in this case consisted of 13 months of payments between September 2009 and November 2010 (with one month not being paid), at the rate of 389 a month, plus any other "provable economic losses." This is a far cry from the treble damages, or $1,500 per violation, as well as punitive damages, which Mr. David might be able to acquire under the UTPA. Moreover, while the agreement does provide that the arbitrator may order payment of "costs," it is unclear whether this encompasses attorney's fees, which are required under the UTPA. Finally, the agreement does not allow for any injunctive relief, nor any additional relief that the court may deem proper, as provided for in the UTPA.

As a result, the arbitration agreement does not provide "the full range of statutory remedies, including punitive damages and attorney fees." Medina. Thus, just as in Medina, "[t]his damages limitation is contrary to public policy and unlawful." Medina. The appropriate relief in such a circumstance depends on whether additional problems are present in the arbitration agreement; the Medina court noted that severance of the unlawful provisions might be proper if they are isolated and easily severable. In this case, however, as is discussed in Part IV, infra, the numerous illegalities present in the agreement make it proper to rescind the agreement entirely.

II. The Arbitration Provision Of The Purchase Agreement Between Mr. David And SAS Is Unenforceable Because It Violates Public Policy To Require Mr. David To Pay Fees And Expenses That Render The Arbitral Forum Unavailable.

The Medina court also articulated that arbitration agreements, in cases involving unwaivable public rights, must "not require [parties] to pay arbitrator's fees or expenses that make a forum inaccessible." Here, the requirements of the arbitration agreement, when compared to the financial status of Mr. David, render the forum inaccessible.

The arbitration agreement requires the parties to pay an equal amount of the costs, although the arbitrator has the discretion to order that the losing party pays the costs. As applied in this case, it would cost Mr. David a $250 filing fee to initiate arbitration and a *minimum* deposit of $1,500 covering two days of proceedings.

Mr. David drives a school bus for a living. His take home pay is only $1,725 a month, and he has three young children for which he is the provider. His family expenses are $1,615 a month, leaving him with $110 in discretionary income each month. In light of his financial circumstances, the State Bar Association referred his case to us, and we accepted it pro-bono. Requiring Mr. David to pay a total of $1,750 to secure two days of proceedings, with potentially increased costs should the proceedings last for more than two days, renders the forum inaccessible to Mr. David. The minimum cost is more than Mr. David makes in a month, and is equally to roughly 17 months worth of his discretionary income. Mr. David should not be forced to choose between spending a year and a half of his discretionary income on arbitral proceedings, or being unable to secure any relief for the unfair and deceptive practices of SAS.

The situation here is analogous to that of Fillman v. Cornado Homes, Inc., where the Columbia Court of Appeals held that the arbitration agreement rendered the arbitral forum financially inaccessible. There, the minimum fee to initiate proceedings was $2,000, and the parties were to split the arbitration fees, which were projected to range between $1,200 and $8,000. Thus, Ms. Fillman might have been required to pay between $2,600 and $6,000. Here, the initial fee is lower, as it is $250, but the two days of proceedings will cost Mr. David $1,500. Moreover, in Fillman it was possible to appeal for a waiver, reduction or deferral in the fees; a possibility that is not present in the text of the present arbitration agreement. Here, the cost could be $1,750 or more for Mr. David, with little possibility for reduction. While it would potentially be possible for Mr. David to obtain costs under the agreement, the same obtained in Fillman, and did not render the forum financially accessible.

In both cases, the parties had little disposable income. In Fillman, the plaintiff was the provider for three children, just as is the case here. Ms. Fillman only earned $1,200 a month, which was spent almost entirely on household expenses; the same is true of Mr. David's $1,725 monthly income. The court in <u>Fillman</u> found it relevant that Ms. Fillman could not pay the $150 filing fee present in that court; in this case, due to Mr. David's financial condition, he is being represented pro bono.

It is true that the plaintiff in <u>Fillman</u> had a more dire financial situation than the plaintiff here. Fillman earned only $300 a week, for a total of $1,200 a month; she was entitled to an additional $600 a month in child support, but was rarely able to collect it. She owed $14,125 in student loans, and $445 for health insurance. Mr. David does earn somewhat more per month than the <u>Fillman</u> plaintiff, and does not have any debts. Moreover, it is also true that the initial fee was higher in the <u>Fillman</u> case than it is here. Nevertheless, his marginally improved situation does not justify a different result. First, the plaintiff in <u>Fillman</u> could have received a waiver of fees, a possibility that does not appear to be present here. Second, Mr. David might be required to pay more than the <u>Fillman</u> plaintiff - Ms. Fillman might have been able to pay as little as $600, even without receiving a fee reduction, to have her claims arbitration. Finally, as an objective matter, Mr. David is teetering on the brink of financial sustainability. His disposable income, as discussed above, is miniscule. This is not because he is spending his funds on frivolous things, but rather because of the cost of raising three children.

As a result, the situation in <u>Fillman</u> is not sufficiently distinguishable from the situation here to warrant a different result. The bottom line is that, in both cases, requiring the parties to submit to arbitration would be fundamentally unfair, because the financial status of the plaintiff would prevent vindication of statutory rights. As the court in <u>Fillman</u> concluded, "Fillman's limited income affords no margin for the expenses of the magnitude required to pay an arbitrator to consider h[is] claim." The same obtains here. As a result, the arbitration agreement is unenforceable, because the costs of arbitration render the forum inaccessible.

III. The Arbitration Provision Of The Purchase Agreement Between Mr. David And SAS Is Unenforceable Because It Is Procedurally and Substantively Unconscionable, As A Result Of The Oppressive Bargaining Process, The Disproportionate Value Of The Car To The Payments Required, And SAS's One-Sided Ability To Proceed Against Mr. David Without Utilizing Arbitration.

The Medina court explained that an agreement to arbitrate "any type of claim," not just a claim involving unwaivable statutory rights, could be unenforceable because it is unconscionable. The court explained that unconscionability has two elements: procedural, and substantive. Procedural unconscionability focuses "on oppression or surprise due to unequal bargaining power," while substantive unconscionability focuses on "overly harsh or one-sided results." Medina. To render a contract unenforceable, "both 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." Here, the contract is both procedurally and substantively unconscionable, and thus enforceable.

The agreement between Mr. David and SAS was procedurally unconscionable. Mr. David is not a sophisticated consumer: he has never bought a car before. SAS took advantage of his inexperience from the moment he set foot in the dealership. When Mr. David entered the auto dealership, he told the saleswoman that he could only afford $200 a month, but she insisted he could afford $389 a month. The saleswoman persisted in saying he could afford it, even when Mr. David again stated that he could only pay $200 a month. The saleswoman then took Mr. David to look at the car, which appeared to be "clean and shiny," despite the fact that it was a four year old used vehicle. She took him for a test drive, and then brought him the papers to buy the car. Mr. David was not informed of the total price until he was given those papers. He was unaware of the ability to negotiate over the price, and instead trusted the saleswoman to give him the correct price. The saleswoman gave him a contract, and stated that he had to sign it to get the car. SAS apparently uses this "standard contract" for every used car sale.

This clearly satisfies the requirements for procedural unconscionability. There was "no opportunity to negotiate," as required by the Medina court. Indeed, the Columbia Supreme Court has found procedural unconscionability in far less egregious situations. In Marshall v. Fermby (1981) the court found a contract procedurally unconscionable even in the case of a prominent promoter of music concerts, because the promoter was "reduced to the humble role of adherent" to the contract. There, the promoter was "required by the realities of his business" to sign the form contracts. Marshall. The same obtains here, except that Mr. David had even less opportunity to negotiate and bargaining power. Mr. David was nothing more than an adherent to the contract, who was provided with no opportunity whatsoever to negotiate, and who had virtually no bargaining power.

It is true that Mr. David was not explicitly prohibited from negotiating. It is also true that the contract provided, in paragraph 5, a statement that he knew he was agreeing to arbitrate disputes, and that he agreed to the terms. Neither of these resolve the problem of procedural unconscionability, however. While Mr. David was not explicitly prohibited from negotiating, the course of events, with the papers being pressed upon him and the saleswoman telling him he had to sign to purchase the car, did not give him a functional ability to negotiate. Moreover, Mr. David found the contract to be full of tiny print, and did not fully appreciate its consequences. As a result, the negotiating and bargaining process, taken as a whole, was still procedurally unconscionable.

The contract is also substantively unconscionable. Mr. David purchased a used 2005 Mazda Tribute for $19,955, plus taxes and fees. Its actual value at the time it was purchased was $9,775. Mr. David was required to pay more than double the actual value of the car. The Marshall court explained that a contract is substantively unconscionable if it is "overly harsh and one-sided." This is clearly the case when someone is required to pay so much more than an item is actually worth.

Moreover, the arbitration agreement here is one-sided. It requires Mr. David to submit all claims to arbitration if they are valued for more than $1,000 in the aggregate. However, according to the arbitration agreement, Mr. David's "failure to provide consideration" as well as SAS's "right to retake possession of the vehicle" "shall not be subject to the arbitration." The agreement also provides that "the Dealer may proceed with Court action in the event the Purchaser fails to pay any sums due under the Agreement." Essentially, the agreement requires Mr. David to submit his claims to arbitration, but does not require SAS to submit any claim to arbitration if it is related to Mr. David's (1) failure to pay or (2) the dealership's right to posses. These are the two most likely reasons that SAS would have to bring a claim against Mr. David, and they need not be brought to arbitration. The Medina court made clear that only requiring one party but not the other to arbitrate claims is substantively unconscionable. The court explained that this "unilateral obligation is so one-sided as to be substantively unconscionable," because only one party is required to waive the benefits and protections of a judicial forum.

As a result, the arbitration agreement is procedurally and substantively unconscionable. There was no real opportunity for bargaining over the terms, the price was excessive in light of the value of the vehicle, and the arbitration agreement is entirely one-sided. Even if Mr. David is unable to show that it is entirely procedurally and substantively unconscionable, that is not his burden: as the Medina court explained, while both elements must be present, a stronger showing on one reduces the need for a strong showing on the other element. Here, Mr. David has made a strong showing on both prongs, and thus this court should find the agreement to be substantively and procedurally unconscionable, and thus unenforceable.

IV. Because The Arbitration Provision Of The Purchase Agreement Between Mr. David And SAS Is Permeated With Unconscionability, The Appropriate Relief Is Rescission Of The Entire Arbitration Provision.

The arbitration provision is unlawful because it (1) limits statutorily provided, unwaivable remedies, (2) renders relief inaccessible given the financial condition of Mr. David and (3) is substantively and procedurally unconscionable. The only remaining question is whether this court should strike down the arbitration provision in whole (i.e. strike the entirety of paragraph 4 from the agreement), or attempt to sever the invalid portions and allow the arbitration to proceed. Here, the only proper relief is to entirely rescind the arbitration portions of the purchase agreement, for several reasons.

First, as the Medina court explained, when an agreement is "permeated" by unconscionability, the appropriate relief is refusing to of the entire arbitration provision. Here, as is explained above, the agreement was both procedurally and substantively unconscionable.

Second, the Medina court identified two factors than weigh against limited severance. If the agreement contains more than one unlawful provision, this weighs in favor of invalidating the entire arbitration provision. Here, the agreement contains not only an unconscionable arbitration provision, but one that also unlawfully limits remedies and renders relief fiscally inaccessible. Just as in Medina, more than simple unconscionability is present: two additional public policy violations exist. In Medina, the court found it sufficient that unconscionability exist and that the agreement limit remedies. The same obtains here, with the additional unlawful aspect of rendering the arbitral forum inaccessible.

Moreover, the Medina court explained that if there is no single provision a court can strike to remove the unconscionable taint, the court should strike the entire arbitral provision because it should not reform the contract. Here, the unconscionable provisions pervade the arbitration agreement: the one-sided nature of the agreement is present in multiple sentences of the arbitration provision, and the limitation on remedies is also present here. The court would essentially have to rewrite paragraph 4 of the purchase agreement, which the Medina court explained is impermissible in a case of unconscionability.

Third, the Medina court identified two factors that would weigh against rescinding the entire arbitration agreement: preventing parties from gaining an undeserved benefit, and attempting to conserve a contractual relationship if doing so does not condone an illegal scheme. Here, neither of these factors is present. Mr. David would not gain an undeserved benefit: he was pressured into signing a clearly unfair contract; it would provide SAS with an undeserved benefit if it were able to enforce the arbitration provision, even with its illegal components excised. Moreover, attempting to conserve a contractual relationship would preserve an illegal scheme - SAS's fraudulent and deceptive practices in connection with the sale of used vehicles, in violation of the UTPA.

Ultimately, as the Medina court explained, "[t]he overarching inquiry is whether severance furthers the interests of justice." Here, limited severance would not further the interests of justice. The entire arbitration portion of the agreement has been tainted by numerous illegalities, and should be stricken as a whole. Mr. David's claims should be heard by a court, rather than an arbitrator.

CONCLUSION

For the foregoing reasons, Plaintiff respectfully requests that this Court deny Defendant's Motion to Compel Arbitration and allow Plaintiff's case to proceed in the Bryant Superior Court. In the alternative, Plaintiff requests that this Court sever the illegal portions of the arbitration agreement, including those limiting plaintiff's remedies, allowing Defendant to proceed outside of arbitration, and requiring Plaintiff to pay half of the arbitration costs.

Answer 2 to Performance Test - B

To: Martin Snider, Partner
From: Applicant
Re: David v. Sovereign Auto Store, Inc.
Date: July 28, 2011

<u>Memorandum of Points and Authorities Opposing the Motion to Compel</u>

<u>I. Statement of Facts</u>

Joe David is a 25-year-old single father of three children, ages 1, 3, and 11. He has a high school education and works as a school bus driver in the Bryant Board of Education. On July 28, 2009, Joe David went to the Sovereign Auto Store (SAS) in Bryant, with the intention of buying an SUV. When he was greeted by the salesperson, Mr. David told her that he could only afford to buy a car that would cost him $200 per month, because of his relatively low wages as a bus driver. Upon hearing this news, the salesperson did a credit check on Mr. David and concluded that he could qualify for a loan allowing him to afford a car costing $389 per month. Again, Mr. David stated that he could only afford a $200 car. Mr. David has never made a car purchase before this one. The only car he ever owned before purchasing the car from SAS was an old car that his uncle had given him as a gift.

The salesperson showed Mr. David a used 2005 Mazda Tribute. After test-driving the car, Mr. David decided that he wanted to purchase it. He doesn't remember the salesperson telling him the total cost of the car until the salesperson brought him some papers to sign in order to finish the transaction.

To complete the purchase, Mr. David was presented with a contract to sign. The contract that Mr. David signed was filled with tiny print and contained an arbitration clause.

After purchasing the car, Mr. David made payments of $389 per month. The terms of the agreement required Mr. David to pay monthly payments of $389 per month for 72 months. Mr. David made the payments between September 2009 and July 2010, but he eventually could not afford to make them any longer. After his doctor recommended that he stop working because of an injury. Mr. David also had to pay his house bill one month and his car bill the next month because of his lack of money.

After missing two payments, SAS repossessed the car from Mr. David in December 2010. SAS then apparently sold the car at an auction for $6,125. SAS then demanded that Mr. David pay an amount equal to $13,368.95.

At the time that SAS sold the car to Mr. David, the Kelley Blue Book value of the 2005 Mazda Tribute was $9,775. However, SAS sold the car to Mr. David for $19,995 -- double the blue book value. Mr. David has stated that he thought that he was purchasing the car for its value, and if he had known that he was paying twice the actual value, he never would have purchased the car.

Pursuant to the arbitration clause in the agreement signed by the parties, SAS wishes to compel David to submit his claim to arbitration. This memorandum in opposition of the motion to compel follows.

II. Argument

A. A mandatory arbitration agreement that compels a party to forfeit statutory rights under the Unfair Trade Practices Act, and which limits the remedies available to the party under that act, is unenforceable because it is contrary to public policy.

Arbitration agreements that force parties to forfeit certain statutory rights are unenforceable. Medina. While some statutory rights may be waived, arbitration agreements that force participants to waive unwaivable statutory rights will be void because they violate public policy. Medina. In fact, a law that is established for a public reason cannot be contravened by a private agreement, and any arbitration that would cause a person to forfeit unwaivable rights under such a law will not be enforced. Medina.

In Medina, the court held that a mandatory arbitration agreement that would compel employees to submit to arbitration any claims arising under the Columbia Fair Employment Act was unconscionable and unenforceable because the statutory protections under CFEA were designed to serve important public purposes. According to the Medina court, there was a public policy against sex discrimination and the law was designed to create a benefit that inured to the benefit of the public, not just the individual employee or employees. As such, the specific statutory rights that were granted under the CFEA were created, defined, and subject to modification only by the legislature and the courts, suggesting the need for a public rather than private means of enforcement. Medina. Because of the important public policy considerations at issue, the mandatory arbitration agreement was unenforceable unless it allowed the person to vindicate the statutory rights. Medina.

Here, a similar public policy consideration governs the dispute between David and SAS. David has sued for relief under the Unfair Trade Practices Act (UTPA) of the Columbia Consumer Protection Code. According to section 1 of the UTPA, the stated purposes 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." In section 7, which deals with remedies, the UTPA states that the remedies in the section may not be waived. Moreover, it allows for the following remedies: treble damages, reasonable attorney's fees, punitive damages, injunction against the use of unlawful trade practices, additional relief as may be necessary to restore to the consumer money or property, and any other relief which the court deems proper. Section 7 of UTPA.

Clearly, like the statute at issue in Medina, the Unfair Trade Practices Act protects important public policy concerns. Such a statute is necessary to make sure that consumers are protected against persons who make misrepresentations as to material fact that has a tendency to mislead, fail to state a material fact if such failure tends to mislead, or make or enforce unconscionable terms or provisions of sales or leases. Section 4 of UTPA. The statute aims to protect consumers against unfair business practices and also serves to deter future conduct by bad actors. By providing consumers who have been deceived by misrepresentations or unfair business practices, the statute serves important public policy goals that cannot be contravened by a contract between public parties.

Moreover, the statute itself states that the remedies under the Act cannot be waived. Thus, any contract that attempts to waive them should be deemed unenforceable, or at least subject to great scrutiny under the Medina decision. Under Medina, a mandatory arbitration agreement that causes a person to forfeit statutory rights must meet 3 requirements: 1) neutral arbitrators; 2) all types of relief available in court; 3) it must not require persons to pay arbitrator's fees or expenses that make a forum inaccessible.

Here, the mandatory agreement that was signed by David states that "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 the sole discretion of the arbitrator." Thus, it eliminates certain remedies that were deemed unwaivable under the UTPA. As such, under Medina it can only be enforced if it meets the 3-part test set forth by that Court. As stated below, the agreement here must not be enforced.

1. Although the agreement allows David to approve the arbitrator chosen by Dealer, when there is an adhesive contract, and fraud and overreaching are present, the court will closely scrutinize the choice of arbitrator.

"The Columbia Arbitration Act seems to contemplate complete contractual autonomy in the choice of an arbitrator." Marshall. Section 29(a) of the CAA allows the parties to set a method for the selection of the arbitrator and states that the method will be followed unless it fails. However, in the case of contracts of adhesion, there is a greater possibility of overreaching and fraud and the court will more closely scrutinize the choice of arbitrator. Here, the agreement provides that Dealer will select the arbitrator, subject to approval by David. In Marshall, the court found that an agreement where the chosen arbitrator was so one sided that they could not be relied upon to remain neutral, the court would not allow the person to serve as an arbitrator. Clearly, if the court believes that there is doubt that the arbitrator will be able to neutrally decide the case, the court may stray from the parties' method even though the CAA generally gives deference to the parties' agreement in this area.

That case is distinguishable from this case because in that case the arbitrator was a member of the union to which the choosing party belonged. There, there was no doubt that the arbitrator would not be able to maintain fairness to the parties. Here, the arbitrator will be chosen by Dealer, and must be approved by David. The fact that David has approval of the choice may protect David. However, the agreement will not meet the other 2 requirements of the Medina test, as explained. Thus, the court must reject the motion to compel arbitration for the reasons stated below.

2. An arbitration agreement that limits the statutory remedies allowed under the Unfair Trade Practices Act is not enforceable because it is contrary to public policy.

In Medina, the court struck down the arbitration agreement because it limited the remedies available under the applicable statute. The court stated, "an arbitration agreement may not limit statutorily imposed remedies such as punitive damages and attorney fees." Medina. Such an agreement would compel arbitration of statutory claims without affording the full range of statutory remedies, and it would be contrary to public policy and unlawful. Medina.

Here, the UTPA allows for treble damages, reasonable attorney's fees, punitive damages, an injunction against the unlawful trade practice, additional relief as necessary to restore to the consumer money or property which may have been acquired by means of the unlawful trade practice, and any other relief which the court deems proper. However, the mandatory arbitration agreement in this case limits the remedies available to the total amount paid by the Purchaser to the Vehicle plus other provable economic loss. Mr. David has sued SAS under the Unfair Trade Practices Act, and has asked for punitive damages. Mr. David has also requested that SAS be required to pay treble damages pursuant to the UTPA. He has also asked for reasonable attorney fees and any other remedy that the court deems proper. In essence, David is seeking to vindicate his rights that are statutorily given to him under the UTPA. Forcing David to participate in mandatory arbitration, and disallowing the remedies that the statute has provided, would be unconscionable, under the Medina decision. Thus, the court cannot grant the motion to compel.

3. A mandatory arbitration agreement that would require an indigent party to pay arbitration costs that the party cannot afford would make the forum inaccessible and would prevent the person from vindicating their statutory rights.

In Fillman, the court struck down a arbitration agreement when it would cause the plaintiff to essentially forfeit any path to remedy because of the expensive costs of arbitration. In that case, the plaintiff was a single mother who was earning a low income. The mandatory arbitration agreement at issue would require her to pay half the costs of the arbitration fees. The court found that such fees are not subject to waiver or deferral even for extreme hardship, and if they are, such waiver would rarely be granted. Because the plaintiff was making very little money, the costs of arbitration were impossible for her to afford. Because the dispute at issue concerned important statutorily created rights, the court held that an arbitration agreement which the plaintiff could not afford amounted to preventing the plaintiff from vindicating those statutory rights. Fillman.

Here, there is a very similar situation to that in the Fillman case. As in Fillman, there is a statute which contains nonwaivable, statutory rights. Also, as in Fillman, Mr. David has very little money. His current monthly take home pay is only $1,725. His various expenses, which include mortgage, utilities, daycare for his children, food and transportation, amount to $1,615. This leaves very little money left over to afford the costs of arbitration. Mr. David was even forced to give up work for a period of time because of his injuries. He was not able to afford the car payments on his Mazda. The arbitration expenses for David would be an initial filing fee of $250 and a minimum deposit of $1,500 which would cover two days of proceedings. As David's finances indicate, he is unable to pay such a large sum. Just like the plaintiff in Fillman, David's finances preclude him from pursuing arbitration. And a mandatory arbitration agreement would preclude him from vindicating his rights. As such, the court must deny the motion to compel.

B. A mandatory arbitration agreement which is imposed by a party of superior bargaining strength, and which contains a unilateral obligation to arbitrate contains elements of both procedural and substantive unconscionability, and it is unenforceable as a matter of public policy.

"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, and vice versa." Medina.

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

Here, the arbitration agreement contains elements of both Procedural and Substantive unconscionabiltiy, and as such, it is unenforceable.

1. The agreement is procedurally unconscionable because SAS is a party with superior bargaining power and David was relegated to the choice of either adhering to or rejecting the contract.

Procedural unconscionability exists when a standard contract is imposed and drafted by a party with superior bargaining strength, and the weaker party has only the option to adhere to or reject the contract. Marshall. Such contracts contain dangers that overreaching and oppression will be employed, and courts will sometimes step in to avoid abuse. Marshall. In Marshall, a contract was procedurally unconscionable when the court found that a party was forced to sign the contract when his stature in the music industry and the realities of his business required him to sign the contract, or sign no contract at all.

Here, David's economic realities and lack of experience, when compared with SAS's business savvy, makes this contract procedurally unconscionable. SAS certainly has superior bargaining strength in this relationship. David is a man who has had very little experience in buying cars. He knows very little about commercial transactions and has never purchased a car. Moreover, he relied on the assurances of the salesperson who told him that he could afford the car. Moreover, it is clear that SAS sold him a car for twice its actual value. SAS has experience selling cars, and knows the value of the cars that it is selling.

Furthermore, David's economic realities and situation made him a weak party in this transaction. He was forced to purchase a car after his car broke down. He has 3 children and he is responsible for their care and well-being. He has very little money and told the salesperson that he was only able to afford a certain amount each month.

Although Medina stated that "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 of failed to read it," here, there are elements of overreaching and fraud. Although David states that he did not read the agreement, and thus didn't know about the arbitration clause, he also states that he believed that the salesperson was giving him a good deal. Moreover, the salesperson was engaging in overreaching because she knew that David wanted a car for $200, but she insisted that he look at cars that were double his budget. There is also evidence of fraud. As stated above, the vehicle that SAS sold to David was worth less than $10,000 at the time of the sale, but the dealership sold it to David for almost $20,000.

In light of these facts, it is clear that David voluntarily signed the agreement. However, because of the presence of overreaching and fraud, the clause is unenforceable.

2. A mandatory arbitration agreement that contains a unilateral obligation to arbitrate is so one-sided as to be unconscionable.

In Medina, the court stated that the agreement contained a requirement that the employee arbitrate, but the employer was not required to arbitrate. The court stated that this clause required the party who was injured to forfeit claims, while allowing the party who required waiver of those rights to be allowed to retain the benefits and protection of the statute. This agreement was held by the court to be so one-sided as to be unconscionable, and the court refused to enforce it.

Here, a similar problem exists. The mandatory arbitration agreement between SAS and David provides that David must arbitrate any claim he has against SAS. However, it also provides that SAS may proceed with court action in the event that David fails to pay any sums due under the agreement. Clearly, this agreement falls into the same category as the one struck down in Medina because it forced David to give up his statutory rights under the UTPA, and yet it allows the Dealer (SAS) to begin a court action against David. This essentially allows SAS to pull all the strings in the situation, and this is contrary to public policy, especially in light of the fact that SAS has likely been engaging in unfair trade practices under the UTPA.

3. When an arbitration agreement is permeated with unconscionability and it is impossible to remove the taint of unconscionability, the court should render the arbitration agreement unenforceable.

When a court finds an unconscionable provision, it may enforce the remainder of the contract without the unconscionable term. When deciding whether to do so, the overriding concern will be what the interests of justice require. Medina. If the court finds that there is no single provision that the court can strike in order to remove the unconscionable taint from the agreement, the court should decide that the agreement is unenforceable in its entirety. If the agreement contains more than one unlawful provision, for example an unlawful damages provision and an unconscionable unilateral arbitration agreement, this weighs in favor of calling the agreement unenforceable. Medina. Multiple defects in the agreement suggest that there was a systematic intent to impose arbitration on the other party. Also, if there is no single provision that the court can strike to remove the unconscionability, then the court should render the agreement unenforceable.

Here, there are multiple defects in the agreement. As explained above, there are unlawful damages provisions because the agreement takes away David's right to attain punitive, treble damages, as well as attorney's fees or injuntion. Furthermore, there is a unilateral arbration which the Medina court plainly stated amounted to substantive unconscionability. As a result of these defects, it is clear that SAS wishes to impose arbitration upon David as a means of controlling the outcome, rather than as an alternative to litigation. Because the unconscionabiltiy truly permeates the agreement as a whole, it would be impossible for the court to sever the agreement so as to make it enforceable. As the Medina court states, "the various provisions that are unconscionable and contrary to public policy make the mandatory arbitration agreement unenforceable as a whole." Thus, the court must deny the motion to compel arbitration.

III. Conclusion

The court should refuse to grant the motion to compel. The mandatory arbitration agreement would cause David to forfeit statutory rights and this would result in a violation of public policy. Moreover, the agreement has elements of procedural and substantive unconscionability. Because the agreement is permeated throughout with the taint of unconscionability, it will be impossible for the court to remove the taint of the agreement without rendering the agreement unenforceable. For these reasons, we ask that you deny SAS's motion to compel arbitration.