Secured Transactions

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1. You should read the instructions, the entire exam and all of the questions before answering any of the questions.

2. This is an open-book (but not open network), three-hour in-class examination. You may consult any materials you wish, except that (i) you may not consult anyone else and (ii) you may not search during the exam on the Internet or on any database service (such as Westlaw or Lexis/Nexis). Please do not discuss the exam with anyone until the examination period is over.

3. This examination consists of five pages. Please make sure that you have all of the pages.

4. There are three questions, with a total of nine (9) units for weighting purposes for grading. Each question consists of 2-4 units and the weight for the question is set forth next to the question.

5. **There is a 3000 word limit for your answer (approx. 333 words per unit).** Penalties may be assessed for failure to comply with these rules and the size of the penalty will be intended to deter violations of the rules.

6. Answers should refer to specific statute sections and cases where relevant. If an exam question is unclear, point out the ambiguity and then answer the question to the best of your ability. If you believe that there is a mistake in the exam, please see the proctor, who will contact me.

7. In answering the questions, you should assume that Revised Article 9 (including the 2010 amendments (using alternative A in 9-503)) is effective in all jurisdictions. You should not assume that caselaw is dispositive of any question, even if it is the caselaw of the jurisdiction in question.

8. **You must connect your answers to the relevant provisions of Article 9, the Bankruptcy Code or any other relevant statute.**

9. Good luck!

Vending machines are, on the whole, a sad experience and our hero, Emeril Lasagna, was ready to change that. Emeril's name as set forth on his birth certificate was "Emeril Lasagna" and he had the same name on his driver's license from the Illinois Department of Motor Vehicles.

In addition to being a great chef, Lasagna was something of a mechanical wizard. He had designed a new vending machine, which he called the RoboChef, but, as the name suggests, it was really much closer to a remote cooking machine. With the appropriate ingredients in the machine and the right instructions, the machine could produce any number of hot, freshly-made foods in quick order.

The instructions were the key to making the RoboChef work. Those instructions were a combination of the recipes for an individual food item as well as the rules that controlled the internal operation of the RoboChef to turn the ingredients into the ordered item. Lasagna had assembled a set of recipes and rules to produce 100 different food items from a basic set of ingredients (the "instructions database"). (Lasagna had asked a lawyer friend about the patentability or copyrightability of the instructions database but was told that the database was almost certainly outside of copyright and patent.)

While the actual ingredients for cooking would need to be loaded into the RoboChef periodically, everything else would be operated wirelessly and remotely. Updated versions of the instructions database could be transmitted to each RoboChef. And the RoboChef would be operated on a cashless basis (credit cards, debits cards and the like) so no cash would need to be collected from the machines.

Question 1 (2 units)

Lasagna set out to turn all of this into a business. On July 1, 2012, Lasagna incorporated DistantChef, Inc. ("DistantChef") as an Illinois corporation. Lasagna transferred a copy of the instructions database to DistantChef, though he of course also kept a personal copy of it. DistantChef operated out of an office in Chicago, where Lasagna served as chief executive officer (CEO). On August 1, 2012, DistantChef approached a custom machine builder, BuildIt, Inc., a Delaware corporation, with its main office in Chicago, to sign a deal for BuildIt to build forty-eight of the RoboChef vending machines.

DistantChef agreed to pay $20,833.33 per machine for a total price under the deal of $1,000,000. BuildIt was to deliver four machines per month on the first day of each month for twelve months. DistantChef was to make only a single payment under the contract of $1,000,000 due on August 1, 2013 the same day the last of the 48 RoboChef machines were to be constructed for DistantChef.

The contract between DistantChef and BuildIt contained the following clause: "DistantChef hereby agrees and grants a security interest in the RoboChiefs built under this contract, in all rights of DistantChef pursuant to this contract and in any property required to operate the RoboChefs and further agrees that such security interests shall secure all obligations hereunder as well as any obligations subsequently owed by DistantChef to BuildIt. DistantChef hereby authorizes BuildIt to make all appropriate filings in connection with this security interest." BuildIt also insisted that DistantChef deliver a copy of the instructions database to BuildIt, which BuildIt stored on one of its office computers.

The next day, BuildIt filed a financing statement with the Illinois Secretary of State, the proper location for financing statement filing in Illinois. In the financing statement, the secured creditor was listed as "BuildIt, Inc.", the debtor was listed as "DistantChef, Inc." and the collateral was described as "equipment, as defined in Article 9 of the Illinois Uniform Commercial Code."

Question: Discuss these transactions.

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Question 2 (4 units)

As BuildIt started to produce the RoboChefs, DistantChef turned getting the RoboChefs placed in the field. DistantChef had three different programs for operating the RoboChefs. In its ownership program, DistantChef would own the RoboChef and would pay a monthly fee to the owner of the space in which the RoboChef was sitting. DistantChef would pay for the ingredients used to produce the food, would set item prices and would receive all of the payments for that food. In its sales program, DistantChef would sell the RoboChef for $100,000 to the purchaser and the purchaser would supply all of the ingredients for the food. The purchaser in turn could decide what prices to set, if any, and would keep any sales receipts from the RoboChef.

Finally, in its leasing program, DistantChef would lease the RoboChef to a customer for $4,000 per month. The customer would have to supply all of the ingredients, DistantChef would set prices and DistantChef and the customer would split revenues from the RoboChef 50/50. Leases were typically on a quarter to quarter basis, automatically renewing, with either side having the right to block renewal of the lease if done on notice at least 30 days prior to the expiration of the current quarter. And the revenue split was implemented such that all of the funds would initially be collected by DistantChef and then DistantChef would send the amount it owed to the lessee 30 days later.

Three months into the contract with BuildIt, as of November 1, 2012, twelve of the RoboChefs had been constructed. Three were still sitting at BuildIt's plant awaiting placement. BuildIt didn't deliver the RoboChefs to

DistantChef as each one was built, but instead sent them directly to the ultimate customer once that person or firm had been identified by DistantChef. Another RoboChef was at DistantChef, where Lasagna used it as a demonstration model for potential customers. Five of the RoboChefs had been sold. Four of those were cash deals and DistantChef has deposited the funds in its checking accounting with FirstChicago Bank ("FCB").

In the fifth case, DistantChef sold the RoboChef to The Jones Law Firm ("JLF"). The law firm was to pay $10,000 per month for twelve months. The sales contract between DistantChef and JLF provided that "The Jones Law Firm hereby grants a security interest in the RoboChef to DistantChef to secure all obligations owed by The Jones Law Firm to DistantChef pursuant to this contract and agrees to act as DistantChef's agent in holding the RoboChef on behalf of DistantChef."

That leaves three RoboChefs unaccounted for. Two of the RoboChefs had been leased to Northwestern University in Evanston, Illinois and located at the student center there. DistantChef deposited the monthly lease payments into its checking account with FCB as it received those payments. Those leases had started on October 1, 2012. Each of the RoboChefs at Northwestern was quickly generating $10,000 per month in credit card transactions (Visa, MasterCard and American Express). Under the merchant agreements that DistantChef had with each of them, the credit card firms owed DistantChef payment in full fifteen days after the end of the month. As those payments came in, DistantChef deposited them in its deposit account at FCB and then subsequently sent funds from that account to pay Northwestern its share of revenues under the lease.

The twelfth and final RoboChef was being owned and operated by DistantChef at DisneyWorld in Orlando, Florida. Disney, a Florida corporation, wanted to experiment with new ways of delivering food at its parks and was temporarily willing to subsidize the experiment by not charging DistantChef any fees for having the device in place there and Disney was stocking the ingredients for the machine from other restaurants that it ran at DisneyWorld. That particular RoboChef was put in place at DisneyWorld on August 15, 2012.

DistantChef was considering expanding its business more rapidly and wanted to borrow $500,000 to do that. On November 10, 2012, it approached BigBank and BigBank and DistantChef agreed to the following terms. BigBank agreed to lend the money on a secured basis with the loan due in full one year later and with an annual interest rate of 10%. On that day, DistantChef executed a promissory note in favor of BigBank setting out those terms. They also entered into a separate security agreement. That agreement authorized BigBank to file appropriate financing statements for these transactions. The security agreement contained the following provision: "DistantChef hereby grants to BigBank a security interest in all now owned or hereafter acquired accounts, deposit accounts, inventory, equipment and general intangibles (all as defined in the Illinois version of Article 9) to secure the promissory note of even date herewith."

The next day, on November 11, 2012, BigBank filed a financing statement with the Illinois Secretary of State. In that statement, the debtor was identified as "The DistantChef, Inc.", the secured party as BigBank and the collateral was identified as "accounts, deposit accounts, inventory, equipment and general intangibles."

Question: Discuss these transactions.

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Question 3 (3 units)

On November 15, 2012, DistantChef set up a new corporation as a wholly-owned subsidiary of DistantChef. The new sub was IDB Holdings, Inc. ("IDB"), a California corporation, with its main office in Chicago. Lasagna understood that having IDB serve as a holding company for the instructions database might reduce applicable taxes. DistantChef transferred all of its rights and title to the instructions database to IDB.

But Lasagna had not appreciated that the database transfer actually operated as an event of default under DistantChef's contracts with BuildIt and BigBank. Both firms feared that the transfer suggested that Lasagna and DistantChef were up to something devious and on November 20, 2012, each declared an event of default and notified DistantChef that they were immediately accelerating any and all obligations of DistantChef to each of the companies.

Each moved to exercise rights. BuildIt sent a notice to Northwestern University indicating henceforth that lease payments for the RoboChefs at Northwestern should sent directly to BuildIt. BuildIt sent another notice to DistantChef announcing that it planned to exercise all of its rights under Part VI of Article 9 as to the three RoboChefs in its possession. And BuildIt sent out a wireless shutdown code for the other nine RoboChefs thereby disabling them from operation.

Meanwhile, BigBank send a notice to FirstChicago Bank seeking to have the funds of the DistantChef's deposit account at FCB turned over to BigBank. This was the first time that FCB had heard of BigBank's claim. As FCB was trying to sort that, BuildIt called FCB and claimed that it was entitled to the account. And as all of that was going on upstairs at FCB, Lasagna appeared at a teller window at FCB and, acting on behalf of DistantChef, sought to take out all of the money from the DistantChef deposit account.

Question: Discuss these transactions.

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