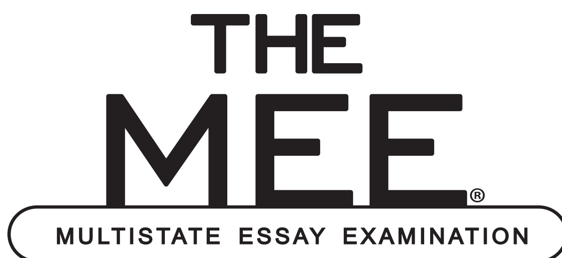

July 2018
MEE Questions and Analyses

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Preface

The Multistate Essay Examination (MEE) is developed by the National Conference of Bar Examiners (NCBE). This publication includes the questions and analyses from the July 2018 MEE. (In the actual test, the questions are simply numbered rather than being identified by area of law.) The instructions for the test appear on page iii.

The model analyses for the MEE are illustrative of the discussions that might appear in excellent answers to the questions. They are provided to the user jurisdictions to assist graders in grading the examination. They address all the legal and factual issues the drafters intended to raise in the questions.

The subjects covered by each question are listed on the first page of its accompanying analysis, identified by roman numerals that refer to the MEE subject matter outline for that subject. For example, the Contracts question on the July 2018 MEE tested the following areas from the Contracts outline: I.A. Formation of contracts—Mutual assent (including offer and acceptance, and unilateral, bilateral, and implied-in-fact contracts); and D. Obligations enforceable without a bargained-for exchange (including reliance and restitution).

For more information about the MEE, including subject matter outlines, visit the NCBE website at www.ncbex.org.

Description of the MEE

The MEE consists of six 30-minute questions and is a component of the Uniform Bar Examination (UBE). It is administered by user jurisdictions as part of the bar examination on the Tuesday before the last Wednesday in February and July of each year. Areas of law that may be covered on the MEE include the following: Business Associations (Agency and Partnership; Corporations and Limited Liability Companies), Civil Procedure, Conflict of Laws, Constitutional Law, Contracts (including Article 2 [Sales] of the Uniform Commercial Code), Criminal Law and Procedure, Evidence, Family Law, Real Property, Torts, Trusts and Estates (Decedents' Estates; Trusts and Future Interests), and Article 9 (Secured Transactions) of the Uniform Commercial Code. Some questions may include issues in more than one area of law. The particular areas covered vary from exam to exam.

The purpose of the MEE is to test the examinee's ability to (1) identify legal issues raised by a hypothetical factual situation; (2) separate material which is relevant from that which is not; (3) present a reasoned analysis of the relevant issues in a clear, concise, and well-organized composition; and (4) demonstrate an understanding of the fundamental legal principles relevant to the probable solution of the issues raised by the factual situation. The primary distinction between the MEE and the Multistate Bar Examination (MBE) is that the MEE requires the examinee to demonstrate an ability to communicate effectively in writing.

Instructions

The back cover of each test booklet contains the following instructions:

> You will be instructed when to begin and when to stop this test. Do not break the seal on this booklet until you are told to begin.
>
> You may answer the questions in any order you wish. Do not answer more than one question in each answer booklet. If you make a mistake or wish to revise your answer, simply draw a line through the material you wish to delete.
>
> If you are using a laptop computer to answer the questions, your jurisdiction will provide you with specific instructions.
>
> Read each fact situation very carefully and do not assume facts that are not given in the question. Do not assume that each question covers only a single area of the law; some of the questions may cover more than one of the areas you are responsible for knowing.
>
> Demonstrate your ability to reason and analyze. Each of your answers should show an understanding of the facts, a recognition of the issues included, a knowledge of the applicable principles of law, and the reasoning by which you arrive at your conclusions. The value of your answer depends not as much upon your conclusions as upon the presence and quality of the elements mentioned above.
>
> Clarity and conciseness are important, but make your answer complete. Do not volunteer irrelevant or immaterial information.
>
> Examinees testing in UBE jurisdictions must answer questions according to generally accepted fundamental legal principles. Examinees in non-UBE jurisdictions should answer according to generally accepted fundamental legal principles unless your testing jurisdiction has instructed you to answer according to local case or statutory law.

July 2018 MEE Questions

Constitutional Law

Contracts

Real Property

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CONSTITUTIONAL LAW QUESTION

In *Gonzales v. Raich,* 545 U.S. 1 (2005), the Supreme Court held that Congress has the power under the Commerce Clause of Article I, Section 8, of the Constitution "to prohibit the local cultivation and use of marijuana," even when applicable state law permits such cultivation and even when the cultivation and use are entirely within state borders. At the time of that decision, at least nine states authorized the use of marijuana for medicinal reasons. Since the decision, medicinal use of marijuana has been approved in numerous other states, and some states have also begun to allow the recreational use of marijuana.

Concerned with the widespread disregard of federal law in states that have "legalized" marijuana use, Congress recently passed the Federal Drug Abuse Prevention Act. Sections 11 and 15 of that Act provide as follows:

> *Section 11.* Any state law enforcement officer or agency that takes any individual person into custody for violation of any state law must make a reasonable investigation within five business days to ascertain whether the individual in custody was under the influence of marijuana at the time of the alleged offense. Such officers or agencies must file monthly reports with the federal Drug Enforcement Agency on the outcome of these required investigations, including the name of any individual determined to have been under the influence of marijuana at the time of his or her alleged offense.
>
> *Section 15.* No state government, state agency, or unit of local government within a state shall be eligible to receive any funding through the federal Justice Assistance Grant program unless use of marijuana is a criminal act in that state.

The Justice Assistance Grant program has been in existence for many years. It is the primary program through which the federal government provides financial assistance for state law enforcement agencies. Last year, the federal government made approximately $300 million in grants to state and local law enforcement agencies through this program. Congress has appropriated another $300 million for such grants in the upcoming fiscal year.

State A has a population of about 4 million people. Its crime rate is below average. Last year, total spending by law enforcement agencies in State A was $600 million, of which $10 million came from federal grants under the Justice Assistance Grant program.

State A recently adopted legislation decriminalizing the use of marijuana for all purposes by persons over the age of 21.

As applied to State A,

1. Is Section 11 of the Federal Drug Abuse Prevention Act a constitutional exercise of federal power? Explain.

2. Is Section 15 of the Federal Drug Abuse Prevention Act a constitutional exercise of federal power? Explain.

CONTRACTS QUESTION

A homeowner, who knew that his neighbor wanted to buy a lawn mower, called the neighbor and offered to sell his lawn mower to her for $350. The neighbor replied, "No way! That price is too high." The homeowner responded, "The price is a good one. See if you can find another lawn mower as good as mine for as little as $350. I'm confident that you'll come to your senses. In fact, I'm so confident that not only am I still willing to sell you the lawn mower for $350, but I promise to keep this offer open for a week so that you have time to do some comparison shopping. If you don't get back to me within a week, I'll sell the lawn mower to someone who knows what a good value it is."

Four days later, the neighbor concluded that $350 was, indeed, a very good price for the homeowner's lawn mower. Accordingly, she decided that she would go see the homeowner the next morning and accept the offer to buy the lawn mower from him for $350. That evening, the neighbor got a telephone call from an acquaintance who lived on the same block as the homeowner and the neighbor. The acquaintance said, "Congratulate me! I just got a great deal on a used lawn mower. [The homeowner] agreed to sell me his lawn mower for $375. At that price, it's a steal. I'm picking it up tomorrow afternoon." The neighbor replied, "This must be a mistake; he offered to sell that lawn mower to me." The acquaintance said, "There's no mistake; we wrote up the deal and everything. I'll come by your place right now and show you the signed contract." A few minutes later, the acquaintance went to the neighbor's house and showed her a signed document pursuant to which the homeowner had agreed to sell his used lawn mower to the acquaintance for $375.

The neighbor went to the homeowner's house the first thing the next morning, rang his doorbell, and as soon as the homeowner came to the door, said, "I accept your offer." The homeowner replied, "Too late. I've agreed to sell the mower to someone else for $375. Next time, act quickly when you are presented with such a great bargain."

The neighbor is furious about the homeowner's refusal to sell her the lawn mower for $350. In her view, the homeowner was bound to keep his offer open for a week and, in any event, her statement "I accept your offer" created a contract that bound the homeowner to the deal.

1. Was the homeowner bound by his promise to keep his offer open for a week? Explain.

2. Assuming that the homeowner was not bound by his promise to keep the offer open, did the neighbor's statement "I accept your offer" create a contract with the homeowner for the sale of the lawn mower? Explain.

REAL PROPERTY QUESTION

In 2015, a man purchased a convenience store that sells gasoline and snack-type grocery items. The man's store is located within two miles of three other convenience stores that are larger and contain small dining areas. When he bought the store, the man planned to expand it as soon as he could in order to offer the same services and products as the other three stores in the area.

In 2017, the local zoning board passed an ordinance that rezoned the district in which all four stores are located from "light commercial" to "residential." Convenience stores are not "residential" uses. The zoning ordinance contained typical language protecting existing nonconforming uses.

In early 2018, the man decided to expand his store by 1,100 square feet to add a small dining area. To finance this expansion, he obtained a $200,000 loan commitment from a local bank, with the funds to be disbursed at such times and in such amounts as the bank determined to be appropriate if, in the bank's good-faith judgment, there was "satisfactory progress" being made on the project. Documents reflecting this commitment were signed by the man and the bank, and a mortgage to secure the repayment of the loan was promptly and properly filed in the local land records office.

Two weeks after obtaining the loan commitment, the man signed a contract with a general contractor for construction of the store expansion. In compliance with its loan commitment, the bank disbursed $50,000 to the man, who, in turn, paid that sum to the general contractor. Construction began immediately thereafter.

Four weeks into the project, a plumbing subcontractor installed all the plumbing fixtures. After the general contractor failed to pay the $20,000 agreed price to the subcontractor, the subcontractor immediately filed a mechanic's lien against the man's property in the local land records office to secure its claim for $20,000.

Eight weeks into the project, the bank disbursed an additional $40,000 to the man, who, in turn, paid $40,000 to the general contractor. The general contractor used these funds to pay various creditors, but not the plumbing subcontractor.

Two weeks ago, a bank loan officer learned for the first time about the mechanic's lien. The next day, when the man approached the bank about making another disbursement, the loan officer refused. The man asserts that, under the loan agreement, the bank is obligated to disburse further funds.

1. Is the expansion project a nonconforming use? Explain.

2. Assuming that the expansion project does not violate the zoning classification, is the bank obligated to disburse further funds? Explain.

3. Does the mechanic's lien have priority, in whole or in part, over the bank's mortgage? Explain.

TRUSTS & FUTURE INTERESTS QUESTION

By his will, a testator created a trust of a small house and an apartment building containing six three-bedroom apartments. The will directed the trustee to sell the house within six months of the testator's death. The will also provided, in relevant part, that "all trust income will be paid to my cousin, Albert, during his lifetime" and that "upon Albert's death, all trust principal will be distributed to my granddaughter, Betty." Neither the will nor the trust made any provision for the testator's son, who was living at the time the will was executed. Shortly after making this will in 2006, the testator died.

After the trust was created, the trustee sold the house for $100,000 and properly invested the sale proceeds. All six apartments in the apartment building were rented at market rates ranging from $1,200 to $1,400 per month.

In 2010, one apartment, which had been rented for $1,300 per month, was vacated. The trustee thereafter rented this apartment to himself for $1,300 per month. The other five apartments continued to be rented throughout the term of the trust at market rates of between $1,200 and $1,400 per month.

In 2012, a portion of the apartment building's roof was destroyed by fire. Because the trustee had not purchased a fire insurance policy, he spent $50,000 to repair the roof. The trustee charged this expense to trust income even though the trust had liquid assets of more than $120,000 that could have been used to pay for the repair. Because the roof repair was charged to trust income, Albert received $50,000 less income from the trust in 2012 than he had received in prior years.

In 2013, Betty died. Betty was survived by her husband and a daughter. Under Betty's duly probated will, she left her entire estate to her husband. If Betty had died intestate, her estate would have been distributed equally between her husband and her daughter.

There is no applicable statute relevant to the disposition of Betty's interest in the trust.

In 2018, Albert died. Albert was survived by Betty's husband and Betty's daughter. Albert was also survived by the testator's son.

1. What fiduciary duties, if any, did the trustee violate in administering the trust? Explain.

2. Upon Albert's death, how should the trust principal be distributed? Explain.

EVIDENCE QUESTION

A woman has sued a man for injuries she received in an automobile collision at a suburban traffic circle in State A on January 1. Both drivers were driving alone, there were no other witnesses, and a forensic accident investigation failed to determine which of the two drivers was at fault.

Among other things, the woman's complaint alleges the following:

1. The woman was driving her pickup truck in the traffic circle at or below the speed limit when the man suddenly pulled his car into the traffic circle immediately in front of her.
2. The man's action left the woman no opportunity to slow down, stop, or avoid colliding with his car.
3. The woman observed that the man was texting on his phone when he entered the traffic circle and did not see him look up to check for traffic before entering the circle.
4. The accident caused the onset of significant neck pain for the woman requiring extensive medical treatment and resulting in lost wages.

The man has denied that he was texting at the time of the accident and alleges that the accident was the woman's fault. According to the man, the woman was driving her truck substantially over the speed limit, her brakes were defective, and despite the fact that the man's car was far ahead of the woman's truck when he entered the traffic circle, the woman failed to slow down to avoid a collision.

A jury trial has been scheduled.

The man's attorney plans to offer the following evidence:

(a) Testimony by a mechanic to the effect that "I inspected [the woman's] truck a week before the accident. The brakes on the truck were worn and in need of repair. I ordered new parts."

(b) A written invoice signed by the mechanic stating: "New parts for [the woman's] truck brakes ordered on December 23 and received on January 2," found in the mechanic's file cabinet among similar invoices for other customers.

(c) Testimony by the woman's doctor, who treated the woman for neck pain after the accident, that the woman told the doctor, "I have suffered from painful arthritis in my neck for the past five years."

The woman's attorney plans to call the man's roommate to testify that "[the man] is addicted to texting and never puts his phone down. He even texts while driving."

Evidence Question

State A has adopted evidence rules identical to the Federal Rules of Evidence.

1. Is the mechanic's testimony admissible? Explain.

2. Is the invoice for the new parts for the woman's truck brakes admissible? Explain.

3. Is the doctor's testimony admissible? Explain.

4. Is the roommate's testimony admissible? Explain.

CORPORATIONS & LLCs QUESTION

A woman and a man decided to start a solar-panel installation business in State X. They agreed to incorporate the business and to be equal shareholders. They also agreed that the woman would be solely responsible for managing the business.

On November 10, the woman mailed to the Secretary of State of State X a document titled "Articles of Incorporation." The document included the name of the corporation (Solar Inc.), the name and address of the corporation's registered agent, and the woman's name and address (as incorporator). The woman, however, inadvertently failed to include in the document the number of authorized shares, as required by the business corporation act of State X, which in all respects comports with the Model Business Corporation Act (1984, as revised). The woman signed the document and included a check to cover the filing fee.

On November 20, the woman, assuming that the articles of incorporation had been filed and purporting to act on behalf of the corporation, entered into a one-year employment contract with a solar-panel installer. The woman signed the employment contract as "President, Solar Inc." and the installer signed immediately below.

On November 30, the woman received a letter from the Secretary of State's office returning the articles of incorporation and her check. The letter stated that the articles, although received on November 15, had not been filed because they failed to include the number of authorized shares, as required by state law.

On receiving this letter, the woman immediately revised the articles by adding the number of authorized shares. On December 5, the woman mailed back the revised articles to the Secretary of State's office, along with another check to cover the filing fee. The revised articles of incorporation were received and filed by the Secretary of State's office on December 10.

Six months later, Solar Inc. went out of business and the installer's employment was terminated.

1. When did Solar Inc. come into existence? Explain.

2. Is the woman personally liable to the installer on the employment contract that she signed? Explain.

3. Is the man personally liable to the installer on the employment contract? Explain.

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ANALYSIS

Legal Problems:

(1) May the federal government force a state law enforcement officer or agency to assist in the enforcement of federal drug laws by requiring the officer or agency to conduct investigations of possible drug use by persons they take into custody and to make reports to the federal government?

(2) May the federal government condition the grant of federal money for state and local law enforcement activities on a state's adoption of laws that criminalize use of federally controlled drugs?

DISCUSSION

Summary

In the Federal Drug Abuse Prevention Act, Congress has sought to induce the states to adhere to the federal policy of criminalizing the use of marijuana. The issue in this problem is whether Congress's efforts in this regard unconstitutionally intrude upon the sovereignty that the Constitution reserves to the states.

Section 11 of the Federal Drug Abuse Prevention Act is unconstitutional because it seeks to commandeer state officers or agencies to provide assistance in the enforcement of federal drug laws. Federal directives requiring the states to carry out federal regulatory programs are inconsistent with the system of dual sovereignty created by the federal structure of the Constitution.

Section 15 of the Federal Drug Abuse Prevention Act, on the other hand, is a constitutional exercise of Congress's spending power. When Congress provides funds to the states, it may condition those funds on a state's compliance with federal directives, provided that the law meets certain requirements. Those requirements are met here: Congress's decision to spend money on state and local law enforcement activities is in pursuit of the general welfare. The condition it is imposing on a state's receipt of that funding is unambiguous. The requirement that federally unlawful drug use must be criminalized at the state level bears a close relationship to the law enforcement objectives of the spending program, and the condition imposed by the federal government is not barred by any constitutional provision. Finally, Congress's threat to withhold a relatively small amount of federal money is not so coercive as to improperly intrude upon state sovereignty.

Point One (50%)

<u>The federal government may not command a law enforcement officer or agency of State A to investigate and report on potential violations of federal law.</u>

The central issue raised by the statute described in this question (the "Federal Drug Abuse Prevention Act") is whether its provisions violate fundamental principles of federalism. Under the system of dual sovereignty established by the Constitution, the States "retai[n] a significant measure of sovereign authority," *Garcia v. San Antonio Metropolitan Transit Authority,* 469 U.S. 528, 549 (1985). The Tenth Amendment confirms that the powers of the federal government are subject, in some cases, to limits necessary to protect "state sovereignty" from federal intrusion. One of those limits is that Congress may not "require the States to govern according to Congress'[s] instructions." *New York v. United States*, 505 U.S. 144, 162 (1992). *See also Hodel v. Virginia Surface Mining & Reclamation Ass'n, Inc.,* 452 U.S. 264, 288 (1981) (federal law that "commandeers the legislative processes of the States by directly compelling them to enact and enforce a federal regulatory program" is unconstitutional); *Murphy v. NCAA*, ___ U.S. ___, 138 S. Ct. 1461 (2018).

In *Printz v. United States,* 521 U.S 898, 935 (1997), the Supreme Court held that "commandeering" of State officials was also unconstitutional under the federalism principle emanating from the Tenth Amendment. In *Printz,* Congress ordered state law enforcement officials to conduct background checks of persons purchasing firearms. By legislating to force the law enforcement officers to take certain actions "in their official capacities as state officers," the Court said, Congress was acting to control their actions "as agents of the State." *Id*. at 930. Such an effort by the federal government "to direct the functioning of the state executive, and hence to compromise the structural framework of dual sovereignty" is unconstitutional. *Id.* at 932. The Court held definitively that "the Federal Government may neither issue directives requiring the States to address particular problems, nor command the States' officers, or those of their political subdivisions, to administer or enforce a federal regulatory program." *Id.* at 935. Section 11 of the Federal Drug Abuse Prevention Act violates federalism principles. The law requires a State A law enforcement officer or agency to undertake investigations aimed at detecting violations of federal drug laws and to report to federal authorities on suspected violations. It seeks to compel state officers to participate in the enforcement of the federal laws against the use of marijuana and thus unconstitutionally intrudes upon state sovereign authority.

Point Two (50%)

<u>The federal government probably can deny federal law enforcement funds to State A if it does not criminalize the use of marijuana.</u>

Section 15 of the Federal Drug Abuse Prevention Act seeks to implement the federal anti-marijuana policy by denying funding from the Justice Assistance Grant program to states that do not criminalize use of marijuana. Congress may use a threat to withhold federal money to induce a state to exercise its sovereign authority (e.g., by passing certain laws) to achieve congressional goals. The Supreme Court has repeatedly held that such threats are constitutional exercises of Congress's power to spend money for the "general welfare of the United States" unless they are unduly coercive.

In *South Dakota v. Dole,* 483 U.S. 203 (1987), the Court held that Congress may condition the states' receipt or use of federal funds on state compliance with "federal statutory and administrative directives." 483 U.S. at 206. When using its spending power in this way, Congress must satisfy certain requirements. First, the spending must be for the general welfare, although a "court should defer substantially to the judgment of Congress" in this regard. *Id*. at 207. Second, the condition imposed by Congress must be imposed unambiguously. Third, the condition imposed must be related "to the federal interest in particular national projects or programs." *Id.* Fourth, the condition imposed must not "be used to induce the States to engage in activities that would themselves be unconstitutional." *Id.* at 210. Finally, a condition will be deemed improper if it is "so coercive as to pass the point at which 'pressure turns into compulsion.'" *Id.* at 211. *See National Federation of Independent Business v. Sebelius,* 567 U.S. 519 (2012) (conditioning continued receipt of Medicaid funds on compliance with new requirements was unconstitutional "economic dragooning that leaves the States with no real option but to acquiesce . . ." because threatened funding constituted over 10% of State budgets. *Id.* at 582).

In this case, Section 15 of the Act is probably constitutional. First, both the federal spending program and the imposed condition are in pursuit of the general welfare. The Supreme Court has said that Congress's view of "the general welfare" deserves substantial deference, and there is no reason to believe that a court would second-guess Congress's judgment that the general welfare is served by assisting with the funding of state law enforcement agencies in states that criminalize the use of drugs that Congress considers dangerous.

The other three basic requirements are also satisfied. The condition being imposed on states that receive funding from this particular program is unambiguous. The condition also relates generally to the purpose of the federal funding, which is evidently to support and improve state and local law enforcement. Finally, a requirement that the states criminalize the use of certain drugs does not induce any state to engage in unconstitutional activity.

The threat of a loss of Justice Assistance Grant funds is probably not so coercive as to amount to an unconstitutional intrusion on State A's sovereignty. The amount of money involved in this case ($10 million) is only a small fraction (less than 2%) of State A's law enforcement budget and thus likely a far smaller part of its total state budget. This is utterly unlike the substantial economic loss (typically 10% of the entire state budget) that faced the states in *Sebelius,* where the Court concluded that the states had "no real option" other than to follow federal wishes. Rather, this is much closer to the "relatively mild encouragement" that was upheld in *South Dakota v. Dole* (requiring South Dakota to raise drinking age to 21 years or lose highway funding amounting to less than half of one percent of the state's total budget). In short, although the funding condition acts as an incentive for State A to adhere to federal policy, it does not "indirectly coerce[]" the State "to adopt a federal regulatory system as its own." *Sebelius,* 567 U.S. at 578. It therefore is a proper exercise of Congress's spending power and does not run afoul of constitutional principles of federalism.

ANALYSIS

Legal Problems:

(1) What body of contract law governs this dispute?

(2) Is a promise to keep an offer to sell goods open for a week binding when the offer is made by a nonmerchant and is not supported by consideration?

(3) Does an expression of acceptance of an offer create a contract when the offeree is aware that the offeror has taken actions inconsistent with an intention to enter into the contract?

DISCUSSION

Summary

Because the lawn mower constitutes "goods," the transaction is within the scope of Article 2 of the Uniform Commercial Code, although common law principles remain applicable to the extent that they are not displaced by the UCC.

The homeowner made an offer to sell the lawn mower to the neighbor and promised to hold that offer open for a week. That promise was not supported by consideration, and no exception in UCC Article 2 overrides the requirement of consideration to make that promise binding. Accordingly, the promise to hold the offer open was not binding.

The neighbor's expression of acceptance of the homeowner's offer would have created a contract for the sale of the lawn mower if the offer had not been revoked. But the offer was probably revoked when the neighbor learned from the acquaintance that the homeowner had contracted to sell the lawn mower to the acquaintance. Thus, the neighbor's attempt to accept the offer was probably too late, and no contract was formed.

Point One (20%)

<u>The lawn mower constitutes goods. Therefore, the transaction between the homeowner and the neighbor is a "transaction in goods" and thus governed by Article 2 of the Uniform Commercial Code.</u>

UCC Article 2 governs "transactions in goods." UCC § 2-102. Lawn mowers are goods. *See* UCC § 2-105(1). Thus, the transaction in question is a transaction in goods that is governed by Article 2 of the UCC. Common law principles remain applicable, though, to the extent not displaced by the UCC. UCC § 1-103(b).

Point Two (40%)

The homeowner's promise to hold his offer open for one week was not supported by consideration and thus, under common law contract principles, was not binding. The promise was not otherwise made enforceable by Article 2 of the UCC.

The homeowner's statement at the beginning of the conversation with the neighbor was an offer to sell her the lawn mower, and her reply was a rejection of that offer. The homeowner followed up, however, by renewing the offer and promising to hold it open for a week. Under the common law of contracts, an offer may be revoked by the offeror at any time before acceptance unless an option contract is created limiting the power of revocation. Restatement (Second), Contracts §§ 25, 87. Here, however, no option contract was created.

First, there was no consideration for the homeowner's promise to keep the offer open, and there was no writing reciting a purported consideration. Restatement (Second), Contracts § 25, cmt. c, and § 87(1)(a). As a result, the promise to hold the offer open was not enforceable under the general rule requiring consideration for such a promise.

Second, as the Restatement notes, a promise to hold an offer open may be made binding by statute. *Id.* § 87(1)(b). Because the lawn mower constitutes goods, Article 2 of the Uniform Commercial Code is the relevant statute. In some circumstances, UCC § 2-205 makes a promise to hold open an offer to buy or sell goods binding, even in the absence of consideration. UCC § 2-205 does not apply in these facts, however. First of all, it applies only to an offer by a "merchant." The term "merchant" is defined in UCC § 2-104(1) as "a person who deals in goods of the kind or otherwise by his occupation holds himself out as having knowledge or skill peculiar to the practices or goods involved in the transaction . . ." Under these facts, the homeowner is not a merchant. Second, UCC § 2-205 applies only to an offer made in a signed writing. In this case, however, the offer by the homeowner was oral. Therefore, the homeowner's promise to hold the offer open was not made binding by statute.

In some cases, "an offer which the offeror should reasonably expect to induce action or forbearance of a substantial character on the part of the offeree before acceptance and which does induce such action or forbearance is binding as an option contract." Restatement (Second), Contracts § 87(2). There is nothing in these facts, however, that would justify application of this rule.

In sum, the homeowner was not bound by his promise to hold the offer open for a week and could revoke it at any time.

Point Three (40%)

A contract would have been formed if the neighbor had accepted the homeowner's offer before it was revoked. Here, the offer was probably revoked when the neighbor learned from the acquaintance that the homeowner had contracted to sell the lawn mower to the acquaintance.

An offeree may accept an offer and thereby create a contract unless the offeree's power of acceptance has been terminated. Restatement (Second), Contracts §§ 35(2), 36. The power of acceptance may be terminated by a rejection or counteroffer by the offeree, the lapse of time, revocation by the offeror, or death or incapacity of either party. *Id.* § 36(1). Here, none of those events is relevant except for revocation by the offeror. (In these circumstances, it does not appear that four days would constitute a sufficient lapse of time, especially in light of the expressed willingness of the homeowner to keep the offer open for a week. *See id*. § 41.) Therefore, the neighbor's power of acceptance was terminated only if the homeowner revoked the offer before the neighbor accepted it.

In most cases, revocation of an offer occurs when the offeree receives from the offeror a manifestation of intention not to enter into the proposed contract. Here, the neighbor did not receive such a manifestation of intention directly from the homeowner before she tried to accept his offer. Yet some cases have held that revocation may also be communicated to the offeree indirectly, when the offeror takes definite action inconsistent with an intention to enter into the proposed contract and the offeree acquires reliable information to that effect. *Id.* § 43. *See also Dickinson v. Dodds,* 2 Ch.D. 463 (U.K., 1876); *Berryman v. Kmoch*, 559 P.2d 790, 795–96 (1977).

In this case, the homeowner took definite action inconsistent with an intention to sell the lawn mower to the neighbor—namely, he entered into a contract to sell it to the acquaintance. Moreover, the neighbor acquired reliable information that the homeowner did not intend to enter into the proposed contract with the neighbor. Not only did the acquaintance tell the neighbor about the homeowner's contract with the acquaintance, but he also showed her their written agreement. Thus, under this principle of indirect revocation, the homeowner revoked the offer, terminating the neighbor's power of acceptance, before her purported acceptance. As a result, there was no contract.

[NOTE: While the Restatement indicates that indirect revocation is a generally applicable principle (and provides illustrations to that effect), the Reporter's Note to Section 43 notes that existing cases all involved real estate transactions. Accordingly, it could be argued that the homeowner had not revoked his offer before it was accepted by the neighbor and a contract was therefore created by the acceptance.]

ANALYSIS

Legal Problems:

(1) Is the expansion project a nonconforming use?

(2) Under the provisions of the loan commitment, is the bank obligated to disburse further funds?

(3) Does the mechanic's lien have priority, in whole or in part, over the bank's mortgage?

DISCUSSION

Summary

The expansion is most likely not a nonconforming use because it results in a substantial change in use that may increase the volume of users at the store's location.

The bank is not obligated to disburse additional funds because the bank and the man entered into a future-advances loan/mortgage arrangement under which future advances depend on the bank's judgment that satisfactory progress is being made on the project.

The bank's mortgage has priority over the mechanic's lien as to the original payment ($50,000) because the mortgage was recorded and the payment was made before the filing of the mechanic's lien. Under the majority rule, the bank has priority with respect to the first future advance ($40,000) because, when it was made, the bank did not have *actual* notice that the subcontractor had not been paid; advances made after the bank acquired such knowledge do not have priority over the mechanic's lien. Under the minority rule, the mechanic's lien is senior to all the future advances but not to the original $50,000 payment because by recording the lien, the subcontractor provided the bank with constructive notice of its interest.

[NOTE: An examinee who wrongly concludes that future advances are obligatory should conclude that the bank has priority with respect to all disbursements made under the loan commitment regardless of when made.]

Point One (35%)

While there are good arguments either way, the expansion to the convenience store is most likely not exempt from the zoning ordinance as a nonconforming use because it would increase the intensity of use.

This zoning ordinance allows uses that existed prior to the enactment of the ordinance. Prior-enactment uses are known as "nonconforming uses" and are justified on both fairness and practical monetary grounds. Here, the convenience store without any expansion is protected by the nonconforming use provision in the ordinance.

While a nonconforming use cannot be extended or intensified in ways that constitute a substantial change, insubstantial changes are permitted, and "owners are entitled to make reasonable alterations to repair their facilities and render them practicable for their purposes." *See* Joseph W. Singer, *Property* 658 (5th ed. 2017). Thus, the issue here is whether the proposed changes are substantial or insubstantial. Because a change would be inconsistent with the zoning law, "any doubts are resolved against the change." *Id*.

Likely, the expansion is not a nonconforming use. The expansion of the convenience store clearly will increase the intensity of the use in the newly zoned residential neighborhood. In fact, that is precisely what the man hopes to achieve with the expansion. Increased use will result in more traffic and possibly impose other externalities on the now residential community. While the goal of the nonconforming-use doctrine is to protect prior investment, it is not to change an existing use into a different investment. Furthermore, applying the nonconforming-use doctrine here would only serve to protect a future investment, not a prior investment. When the man bought the store, he had only a mere expectation of future investment (i.e., that he would expand the store to offer products and services similar to those offered by the other convenience stores). A mere expectation is not an investment.

On the other hand, the proposed alteration should arguably be treated as a permissible nonconforming use because it is necessary for the man's store to compete effectively with the three other stores in the area. Furthermore, other local convenience stores that sell gas have small dining areas within them, and thus the expansion could be viewed as merely a normal expansion of a prior nonconforming use. Additionally, the point of the nonconforming-use doctrine, in part, is to protect the investment-backed expectations of persons, such as the man here, who purchased and operated the store in reliance on the law in place when the property was acquired. This expectation exists here, given that when the man purchased the store there were three more expansive convenience stores in the area, and he had expected that in the future he would expand the store to offer the same products and services as his competitors.

However, notwithstanding the argument in favor of applying the nonconforming-use doctrine to the store's expansion, given that "any doubts are resolved against the change," it is more likely that the expansion is *not* a nonconforming use. *Id*.

Point Two (35%)

<u>The bank's obligation to make advances to the man is optional because future advances are conditioned on the bank's determination that the borrower is making satisfactory progress on the construction project.</u>

The type of loan/mortgage here is a so-called "future-advances" agreement, and it is very common in the construction industry. A future-advances loan is one in which the lender provides funds to the borrower over a period of time, rather than in a lump sum at the signing of the mortgage, in order to finance ongoing construction when the funds are needed. Future-advances loans are either obligatory or optional. A future-advances loan is obligatory if the lender has a duty to advance the funds; the loan is optional if the lender does not have a duty to advance funds but has discretion whether to make future advances. *See* Grant S. Nelson, Dale A. Whitman, Ann M. Burkhart & R. Wilson Freyermuth, *Real Estate Finance Law* 1095 (6th ed. 2015).

In this case, the bank's commitment to make future advances is optional. A commitment is obligatory only when the lender commits to making future advances without discretionary conditions. With a satisfactory-progress condition, the bank has no "definite obligation to advance any funds," making the future advances optional. *Id*. at 1099. The satisfactory-progress condition is designed, among other things, to permit the bank to withhold funds if any difficulties associated with the project's completion threaten the bank's security by reducing the growth in value anticipated from the project.

Here, the bank has a right to withhold funds if it concludes in good faith that there is not "satisfactory progress" on the project. The existence of a mechanic's lien against the project could undermine the bank's security with respect to future amounts it might disburse if the mechanic's lien has priority. *See* Point Three. Thus, the bank officer's concerns could justify withholding funding.

Point Three (30%)

<u>With respect to the $50,000 payment, the bank's mortgage has priority as it preceded the filing of the mechanic's lien. With respect to the $40,000 payment, under the majority rule, the bank's mortgage has priority over the mechanic's lien because the bank did not have actual knowledge that the subcontractor had not been paid when the bank made the payment. Under the minority rule, the bank's mortgage would not have priority because the lien was properly filed before the bank made this payment.</u>

The general rule is that, if a future advance is obligatory, the mortgage securing that advance takes priority over creditors who file liens after the mortgage is recorded, even if all advances on the loan have not actually been made. Nelson et al., *supra*, at 1095. Because the bank must make the future payments, regardless of circumstances, those payments are deemed to have been made when the mortgage was created. It is as though the loan had been paid in one lump sum at that time.

[NOTE: If an examinee concludes that future advances are obligatory, that examinee should also conclude that the mechanic's lien is junior to all disbursements made by the bank.]

If the future advances are optional, and if the mortgagee has notice when it makes the advance that a subsequent lienor has acquired an interest in the land, then the advance loses its priority to that creditor. *Id*. at 1095. Here, the bank has priority only to the original $50,000 advance but not to the $40,000 advanced after the mechanic's lien was filed, assuming that the bank had notice of it. And, of course, if the bank were to continue to make advances up to the $200,000 commitment, those additional payments would not have priority. However, this rule applies only if the bank made the advances with "notice" of the lien.

Most states hold that the mortgagee has notice only when it has actual notice of the lien at the time of the future advance. *Id*. at 1102. This rule is based on the view that the mortgagee should not have the burden of a title search each time it makes an advance when it is easier for the subcontractor to inform the mortgagee that its bill has not been paid.

Here, application of this approach would lead to the conclusion that the bank had no notice of the mechanic's lien until it learned that the subcontractor had not been paid when the third advance was sought. Thus, the bank would have priority over the subcontractor with respect to the first two payments ($50,000 and $40,000). Of course, should the bank make additional future advances, as to those it would not have priority.

Under the minority view, the bank will be charged with constructive notice of the mechanic's lien if the lien, as here, has been properly recorded. *Id.* Under this view, the assessment of the relative burdens of the mortgagee and the subcontractor are reversed. If the minority view applies, the bank has priority with respect to the original advance of $50,000 but not to any later advances because it had constructive notice of the mechanic's lien as of the time it was filed.

ANALYSIS

Legal Problems:

(1)(a) Did the trustee breach the duty of loyalty by renting a trust-owned apartment to himself at a market rate?

(1)(b) Did the trustee breach the duty of prudent administration (a/k/a duty of care) by failing to purchase fire/casualty insurance on trust property, resulting in a $50,000 uninsured loss?

(1)(c) Did the trustee breach the duty to administer in accordance with applicable law by allocating the entire $50,000 expense occasioned by the unexpected roof repair to trust income?

(2) Upon Albert's death, should the trust principal be distributed to Betty's husband, Betty's daughter, equally to both of them, or to the testator's heirs?

DISCUSSION

Summary

The trustee breached the fiduciary duty of loyalty when the trustee rented one of the apartments to himself even though it appears that he paid a market rate for the apartment. The trustee breached the duty of prudent administration (a/k/a duty of care) by failing to purchase fire insurance on the trust's real property. The trustee breached the duty to administer in accordance with applicable law by charging the entire uninsured loss to income rather than principal.

Under the common law, upon Albert's death the trust principal would pass to Betty's husband because she had a vested remainder in the trust that passed to him under her will. The testator's son would not share in trust principal because there is no reversion to pass to the testator's heirs.

Point One(a) (25%)

<u>The trustee breached his duty of loyalty when he rented a trust-owned apartment to himself even though he paid a market rate.</u>

A trustee owes trust beneficiaries a duty of loyalty. This duty arises under the common law and by statute. Under the common law, a trustee is prohibited from making transactions that place the interest of the trustee or another above the interest of trust beneficiaries. *See* William M. McGovern, Sheldon F. Kurtz, David M. English & Thomas P. Gallanis, *Wills, Trusts, and Estates* 530 (5th ed. 2017). The duty of loyalty prohibits two types of transactions: self-dealing, where the trustee deals with trust property for the trustee's personal benefit, and conflict of interest, where the trustee acts on "behalf of others to whom the trustee also owes obligations." *Id*. at 531. Here, the trustee's lease of a trust-owned apartment to himself was self-dealing. The lease thus breached the trustee's duty of loyalty.

Because of the so-called "no-further-inquiry" rule, the fact that the trustee paid a market rate is irrelevant to the conclusion that the trustee engaged in self-dealing. *Id.* at 531–532. *See also* Restatement (Third) of Trusts § 78(2) ("the trustee is strictly prohibited from engaging in transactions that involve self-dealing or that otherwise involve or create a conflict between the trustee's fiduciary duties and personal interests."). As noted in the Restatement (Third), under the no-further-inquiry rule, "it is immaterial that the trustee may be able to show that the action in question was taken in good faith, that the terms of the transaction were fair, and that no profit resulted to the trustee." *Id*. cmt. b. This strict approach is justified on the grounds that "it may be difficult for a trustee to resist temptation when personal interests conflict with fiduciary duty. In such situations, for reasons peculiar to typical trust relationships, the policy of the trust law is to prefer (as a matter of default law) to remove altogether the occasions of temptation rather than to monitor fiduciary behavior and attempt to uncover and punish abuses when a trustee has actually succumbed to temptation. This policy of strict prohibition also provides a reasonable circumstantial assurance (except as waived by the settlor or an affected beneficiary) that beneficiaries will not be deprived of a trustee's disinterested and objective judgment." *Id*.

The Uniform Trust Code takes a similar approach. It adopts the no-further-inquiry rule and provides that a self-dealing transaction is voidable by trust beneficiaries. *See* UTC § 802(b). As noted in the comments, "transactions involving trust property entered into by a trustee for the trustee's own personal account [are] voidable without further proof. . . . It is immaterial whether the trustee acts in good faith or pays a fair consideration." *Id*. at comment.

Point One(b) (25%)

The trustee breached his duty of prudent administration (a/k/a duty of care) when he failed to purchase fire/casualty insurance on the real property.

Both the Restatement of Trusts and the Uniform Trust Code impose on trustees a "duty of prudent administration." *See* Restatement (Third) of Trusts § 77 ("The trustee has a duty to administer the trust as a prudent person would, in light of the purposes, terms, and other circumstances of the trust"); UTC § 804 ("A trustee shall administer the trust as a prudent person would, by considering the purposes, terms, distributional requirements and other circumstances of the trust."). Both authorities agree that, to satisfy the duty of prudent administration, a trustee must "exercise reasonable care, skill, and caution." *See* Restatement (Third) of Trusts § 77(2); UTC § 804.

The Uniform Trust Code further provides that a "trustee shall take reasonable steps to take control of and protect the trust property." UTC § 809. This section is based upon Restatement (Second) of Trusts § 176. A comment to § 176 of the Restatement specifies that a trustee's failure to purchase fire/casualty insurance for trust property when such "insurance is customarily taken by a prudent" person is a breach of the duty to protect (a subset of the duty of care/prudent administration). Restatement (Second) of Trusts § 176 at cmt. b, illus. 3. *Accord, Hamilton v. Mercantile Bank of Cedar Rapids*, 621 N.W.2d 401 (Iowa 2001).

Here, the trustee failed to purchase a fire/casualty policy on the trust's rental property, resulting in a loss to the trust. This is a breach of trust because a prudent person would have purchased such a policy on the property.

[NOTE: An accurate analysis of the legal standards is more important than the examinee's conclusion regarding whether the purchase of insurance would have been prudent.]

Point One(c) (30%)

<u>The trustee breached his duty to administer the trust in accordance with applicable law by allocating the $50,000 repair expense exclusively to income.</u>

A trustee has a duty to administer the trust "diligently and in good faith, in accordance with the terms of the trust and applicable law." Restatement (Third) of Trusts § 76. *Accord*, UTC § 801. Because of the trustee's obligation to comply with applicable law, the trustee must comply with the Uniform Principal and Income Act, or other state statutes of like effect, in allocating receipts and disbursements between trust income and principal.

Under the Uniform Principal and Income Act, "all . . . ordinary expenses incurred in connection with the . . . preservation of trust property . . . including ordinary repairs" are allocated to income. Extraordinary repairs are allocated to principal. Unif. Principal and Income Act § 501 (1997). Ordinary repairs are repairs required by day-to-day wear and tear. Extraordinary repairs are repairs required by "an unusual or unforeseen occurrence that does not destroy the [asset] but merely renders it less suited to its intended use, a repair that is beyond the usual, customary, or regular kind." *See generally Black's Law Dictionary* 267 (2d pocket ed. 2001).

Here, the $50,000 roof repair was extraordinary because it was required by an unforeseen occurrence, a fire. It should therefore have been allocated to principal, not income, and paid from the trust principal's $120,000 in liquid assets. This conclusion is bolstered by the fact that, had the trustee obtained insurance on the property, the insurance proceeds, representing the value of needed repairs, would have been allocated to principal. Unif. Principal and Income Act § 404.

[NOTE: The duties discussed in this section are sometimes referred to as an aspect of the duty of impartiality.]

Point Two (20%)

<u>Under the common law, upon Albert's death, the trust principal should be distributed to Betty's husband because she devised her vested remainder in the trust to him.</u>

Under the terms of the trust, the testator created a life estate in Albert and a remainder interest in Betty. Under the common law, Betty's interest was vested because it was subject to no contingencies (such as "to Betty if she survives Albert") that would cause her to lose her interest should she predecease Albert. *See generally* Herbert Hovenkamp, Sheldon F. Kurtz & Thomas P. Gallanis, *The Law of Property, An Introductory Survey* 128 (6th ed. 2014). Vested remainders are devisable. Thus, if the remainderman is not living when the remainder becomes possessory, it passes to the devisee of the interest under the deceased remainderman's will. *Id*. at 127.

Here, trust principal became possessory at Albert's death, and Betty was not living at that time. The trust principal thus should go to the devisee named in Betty's will, her husband. Under the common law, the testator's son would not take a share of trust principal as there is no reversionary interest to pass to the testator's heirs.

[NOTE: If Betty's trust interest were subject to a survivorship contingency, that would have caused Betty's interest to fail because she predeceased Albert. In that case, her interest would have reverted to the testator's estate. In such case, it would have passed to his heirs if he died intestate or to his beneficiaries if he died with a will.]

ANALYSIS

Legal Problems:

(1) Is a mechanic's testimony describing his opinion of the condition of truck brakes that he has inspected admissible evidence?

(2) Is an invoice for truck brake parts an admissible business record when it was apparently made by a person with knowledge of its contents and retained in the ordinary course of business?

(3)(a) May a patient assert the physician-patient privilege to bar admission of a physician's trial testimony if the patient has placed her medical condition in issue by filing a personal injury lawsuit?

(3)(b) Is a patient's out-of-court statement regarding pre-existing pain admissible as a statement by an opposing party when the patient is the plaintiff in a personal injury lawsuit or admissible under the hearsay exception for statements made for the purpose of medical diagnosis or treatment?

(4) Is the roommate's testimony admissible habit evidence?

DISCUSSION

Summary

The mechanic's proposed testimony that he inspected the woman's truck brakes and that they needed repair is relevant because it has some tendency to make it more probable that a malfunction of the truck's brakes caused the accident. Although the proposed testimony is an opinion, it should be admitted because it would be rationally based on the mechanic's personal perception of the condition of the brakes, and the opinion would be useful to the trier of fact. In the alternative, the mechanic's opinion could be admitted as expert testimony based on his technical skill or expert knowledge, if the opinion is the product of reliable principles and methods and the mechanic reliably applied the principles and methods to the facts of the case.

The invoice from the mechanic's shop stating, "New parts for [the woman's] truck brakes ordered on December 23 and received on January 2," is relevant because it has some tendency to make it more probable that the accident was caused by brake malfunction in the woman's truck. The mechanic's out-of-court statement is hearsay, but it fits the hearsay exception for "business records" because the mechanic, who signed the invoice, was a person with knowledge of the information in the invoice and the facts suggest strongly that the invoice was made and kept in the ordinary course of the mechanic's business.

The doctor's proposed trial testimony that the woman told him "I have suffered from painful arthritis in my neck for the past five years" is also admissible. The statement is relevant because it has some tendency to make it less probable that the woman's neck pain was caused by the accident, but instead by arthritis that predated the accident. By filing this civil lawsuit alleging that the accident caused the onset of neck pain, which placed her medical condition "in issue," the woman thereby waived the physician-patient privilege.

The doctor's testimony repeats an out-of-court statement by the woman. However, because the declarant (the woman) is the plaintiff, it is not hearsay because it is an opposing party's statement when offered by the defendant (the man). In the alternative, it fits the hearsay exception for statements made for the purpose of medical diagnosis or treatment.

Finally, the roommate's testimony ("[The man] is addicted to texting and never puts his phone down. He even texts while driving.") may be admissible as evidence of the man's "habit" of constant texting. This is a close call. The testimony is relevant because it has some tendency to make it more probable that the man was texting at the time of the accident. However, the court must first decide whether constant texting is a habit. Texting is a volitional act and requires conscious effort. Most courts limit the scope of habit evidence to relevant behaviors that are consistent and semi-automatic. Texting may be too volitional to be considered semi-automatic by some courts, but courts that consider the similarity and repetition of behaviors might view evidence of constant texting as habit evidence.

Point One (20%)

<u>The mechanic's testimony about the condition of the brakes is relevant and should be admitted either as lay opinion rationally based on the mechanic's personal perception or as expert opinion because the mechanic possesses the necessary technical knowledge to be qualified as an expert witness.</u>

Evidence is relevant if it has "any tendency to make a fact more probable or less probable than it would be without the evidence." Fed. R. Evid. 401(a). The mechanic's testimony ("I inspected [the woman's] truck a week before the accident. The brakes on the truck were worn and in need of repair. I ordered new parts.") is relevant because it tends to make it more probable that a brake malfunction may have caused the accident.

The mechanic's testimony is admissible opinion evidence. Under Federal Rule of Evidence 701, lay opinion testimony is admissible if it is "(a) rationally based on the witness's perception; (b) helpful to clearly understanding the witness's testimony or to determining a fact in issue; and (c) not based on scientific, technical, or other specialized knowledge within the scope of Rule 702." Fed. R. Evid. 701. Courts typically hold that witnesses with "firsthand knowledge" may "offer lay opinion testimony where they have a reasonable basis—grounded either in experience or specialized knowledge—for arriving at the opinion expressed." *Asplundh Mfg. Div. v. Benton Harbor Engineering*, 57 F.3d 1190 (3d Cir. 1995). Here, the mechanic's opinion is rationally based

on his personal perception and would be helpful to the jury's determination of whether the woman or the man caused the accident. A court could also find that because the mechanic's opinion is based on his personal perception, it is not an expert opinion within the scope of Rule 702.

In the alternative, the mechanic may be qualified as an expert based on his technical skill or specialized knowledge. Under Federal Rule of Evidence 702, the mechanic's expert opinion can be admitted if "(a) the expert's scientific, technical, or other specialized knowledge will help the trier of fact to understand the evidence or to determine a fact in issue; (b) the testimony is based upon sufficient facts or data; (c) the testimony is the product of reliable principles and methods; and (d) the expert has reliably applied the principles and methods to the facts of the case." Fed. R. Evid. 702. Here, a court could find that the mechanic used his technical skills to reliably form the opinion that the woman's truck brakes required repair, making the opinion testimony admissible under Rule 702, but not Rule 701.

Regardless of whether the mechanic's testimony is viewed by the court as lay or expert opinion, it should be admitted.

Point Two (20%)

The receipt from the mechanic's shop is a relevant out-of-court statement that should be admitted because it fits the hearsay exception for business records.

The receipt from the mechanic's shop stating "New parts for [the woman's] truck brakes ordered on December 23 and received on January 2" is relevant because it has some tendency to make it more probable that the woman's truck brakes were, in fact, in need of repair and may have malfunctioned, causing the accident. Fed. R. Evid. 401.

The receipt is hearsay under Federal Rule of Evidence 801 because (1) it is a statement (the mechanic's "written assertion" that new brake parts were ordered); (2) the mechanic made the statement out of court; and (3) the statement will be "offer[ed] in evidence to prove the truth of the matter asserted in the statement." Fed. R. Evid. 801. However, the receipt fits the hearsay exception for "business records." Under Rule 803(6), a business record may be "a record of an act, event [or condition]" made "by someone with knowledge, if kept in the course of a regularly conducted activity of a business, and if making the record was a regular practice of that activity." Fed. R. Evid. 803(6). These facts must be shown by the testimony of the custodian of the record or another qualified witness.

Here, the mechanic was a person with knowledge because he ordered the truck brake parts, as he will testify. The fact that the receipt was written and signed by the mechanic and kept in the mechanic's file cabinet among similar receipts for other customers should establish that the mechanic was the custodian of the receipt and that it was made and kept by the mechanic in the ordinary course of his repair business. But the receipt will be admissible only if these facts are established during examination of the mechanic.

Point Three(a) (15%)

The doctor's proposed testimony is relevant to the cause of the woman's neck pain and would not be protected by the physician-patient privilege because the woman effectively waived the privilege by filing this civil lawsuit, which placed her medical condition "in issue."

The doctor's proposed testimony that the woman said, "I have suffered from painful arthritis in my neck for the past five years," is relevant because it has some tendency to make it less probable that the accident caused the onset of the woman's neck pain. Fed. R. Evid. 401.

Under Rule 501 of the Federal Rules of Evidence, "state law governs privilege regarding a claim or defense for which state law supplies the rule of decision." Fed. R. Evid. 501. The physician-patient privilege, which was not recognized at common law, has been adopted by statute in most jurisdictions. *See* 25 Wright and Graham, *Federal Practice and Procedure* § 5521 (2015). In determining whether to honor the assertion of a privilege, "courts must balance the public interest in nondisclosure against the need of the particular litigant for access to the privileged information, keeping in mind that the burden of persuasion rests on the party seeking to prevent disclosure." *See Stinson v. City of New York*, 304 F.R.D. 432, 435–36 (S.D.N.Y. 2015).

In most jurisdictions, patient communications or disclosures made for the purpose of medical diagnosis or treatment are privileged. *See State v. Ortiz*, 698 P.2d 1301 (Ariz. Ct. App. 1985). However, most jurisdictions currently recognize a range of exceptions intended to prevent the privilege from being used as a shield for fraud. These exceptions apply in any proceeding where the patient relies on a physical condition as an element of his claim or defense. Thus, in many states a patient waives the physician-patient privilege by placing her medical condition "in issue" in a personal injury lawsuit. *See Roosevelt Hotel Ltd. Partnership v. Sweeney*, 394 N.W.2d 353 (Iowa 1986).

The woman should not be able to invoke the physician-patient privilege to bar admission of the doctor's statement. She will be deemed to have waived the privilege by seeking damages for her neck pain, which put the question of the cause of that pain into issue in the lawsuit.

Point Three(b) (20%)

The doctor's proposed testimony would repeat an out-of-court statement by the woman, but the woman's statement is admissible because (1) it is a statement by an opposing party and is therefore not hearsay, or (2) it fits the hearsay exception for statements made for medical diagnosis or treatment.

The doctor's statement, which repeats an out-of-court statement by the woman (that she had suffered from painful arthritis in her neck for the past five years), is admissible for the truth of the matter asserted and is not hearsay. When offered by the defendant (the man), it is an opposing party's statement because the declarant is the plaintiff (the woman). Fed. R. Evid. 801(d)(2).

In the alternative, the woman's statement, which describes the onset and nature of her neck pain, describes her "medical history" and provides information about her "past or present symptoms or sensations; their inception; or their general cause." Fed. R. Evid. 803(4). Under these circumstances, the woman's statement is also admissible under the hearsay exception for statements made for medical diagnosis or treatment. *See id*.

Point Four (25%)

The court may admit testimony by the roommate if it decides that the man's constant texting is a habit. A court might rule either way.

The roommate's testimony ("[The man] is addicted to texting and never puts his phone down. He even texts while driving.") is relevant because it has some tendency to make it more probable that the man was texting at the time of the accident. Fed. R. Evid. 401.

Under Federal Rule of Evidence 406, "evidence of a person's habit . . . may be admitted to prove that on a particular occasion the person . . . acted in accordance with the habit." Fed. R. Evid. 406. Typically, under Rule 406, a person's "habit" is defined as his or her consistent response to a specific situation. The court may admit habit evidence "regardless of whether it is corroborated or whether there was an eyewitness." *Id*. Testimony involving habit evidence may be given by the person with the habit or by another person, but the person testifying must have personal knowledge.

It is sometimes difficult for courts to distinguish habit evidence from character evidence. The problem is that, depending on the habit described, habit evidence can be similar to evidence of a person's character or prior acts. The Federal Rules of Evidence generally prohibit the use of evidence of a person's character "to prove that on a particular occasion the person acted in accordance with the character or trait." Fed. R. Evid. 404(a). The Rules likewise prohibit evidence of other acts when offered to prove a character trait and action in conformity with that trait. Fed. R. Evid. 404(b). Because "habit" evidence can run afoul of the bans on character evidence and prior bad acts evidence, courts generally limit habit evidence to proof of relevant behaviors that are not just consistent but semi-automatic. *See Weil v. Seltzer*, 873 F.2d 1453, 1460–61 (D.C. Cir. 1989).

Here, it is a close question whether the roommate's testimony is admissible habit evidence or prohibited character evidence. According to the advisory committee notes to Rule 406, a habit "is the person's regular practice of meeting a particular kind of situation with a specific type of conduct." The roommate would testify that texting is the man's constant and consistent practice. But as noted above, many courts also require that the behavior be semi-automatic in order to be admissible as habit evidence, and texting may be too volitional to be considered a semi-automatic habit.

ANALYSIS

Legal Problems:

(1) When did Solar Inc. come into existence?

(2)(a) Under the state's business corporation statute, could the woman be personally liable on the contract with the installer that she signed as "President, Solar Inc."?

(2)(b) Under general partnership law, could the woman be personally liable on the contract with the installer?

(3) Is the man personally liable to the installer on the employment contract?

DISCUSSION

Summary

Normally, a corporation comes into existence with the filing of articles of incorporation. See Model Business Corporation Act (MBCA) § 2.03(a). Here, the corporation came into existence on December 10 when the corrected, resubmitted articles were filed by the Secretary of State's office.

The liability of participants in a business that has not been properly incorporated can arise under statute or as a matter of partnership law. Under MBCA § 2.04, persons who purport to act on behalf of a corporation prior to incorporation, knowing that there is no incorporation, become personally liable. Here, the woman would not be liable under MBCA § 2.04 because she did not have actual knowledge, at the time of the dealings with the installer, that the corporation had not been incorporated.

Under partnership law, persons who carry on as co-owners a business for profit become liable as partners. Although the woman would appear to be a partner in an unincorporated business, a court applying common law doctrines in cases of defective incorporation is likely to infer corporate limited liability with respect to the contract claim by the installer against the woman.

However, under the "de facto corporation" doctrine, a court is likely to find that the woman is not personally liable to the installer because the woman made a good-faith attempt to incorporate and then entered into the contract in the corporate name. A court could also apply the "corporation by estoppel" doctrine to find that the woman is not personally liable to the installer because the installer dealt solely with the corporation, without relying on the personal assets of the woman.

As for the installer's claim against the man, the man (as an inactive investor in the business) is even less likely to be personally liable. The man did not purport to act on behalf of the

corporation and thus cannot be liable under MBCA § 2.04. In addition, even though the man may have been a partner in the unincorporated business, a court would likely apply the two defective-incorporation doctrines to infer limited liability for the man.

Point One (10%)

The corporation was formed on December 10, when its articles of incorporation were filed by the Secretary of State's office.

Normally, the existence of a corporation begins with the filing of the articles of incorporation. MBCA § 2.03(a) ("Unless a delayed effective date is specified, the corporate existence begins when the articles of incorporation are filed"). The articles were not filed on November 15 when they were received by the Secretary of State because they failed to include the number of authorized shares as required by the statute. Here, the corporation came into existence on December 10 when the corrected, resubmitted articles were filed by the Secretary of State's office.

[NOTE: An examinee might point out that sometimes filings can be corrected, with the corrections effective as of the date of the original filing. See MBCA § 1.24(a) (permitting a corporation to file "articles of correction," which become effective as of the date of the document they correct, provided that the corrections are limited to inaccuracies, defective signatures, and defects in electronic transmission). Here, however, the Secretary of State's office did not accept the original articles for filing, and there was no "filed document" to correct.]

Point Two(a) (25%)

The woman would not be personally liable under MBCA § 2.04 because when she entered into the contract on behalf of the corporation, she did not know that the business had not been properly incorporated.

Under the MBCA, "persons purporting to act as or on behalf of a corporation, knowing there was no incorporation . . ., are jointly and severally liable for all liabilities created while so acting." MBCA § 2.04. The Official Comment clarifies that an "erroneous but in good faith" belief that incorporation has happened does not constitute knowledge under the section. Official Comment, MBCA § 2.04 (adopting approach of Revised Uniform Limited Partnership Act).

Here, the woman is likely not liable for "purporting to act . . . on behalf" of a non-existent corporation under MBCA § 2.04. There is no indication that she actually knew that the original articles had not been filed by the Secretary of State when she entered into the employment contract with the installer in the corporate name. Although the woman could have checked with the Secretary of State's office to ascertain whether the business had been incorporated or possibly should have known that the articles were incomplete, her lack of actual knowledge of the incorporation defect precludes her liability under MBCA § 2.04.

Point Two(b) (40%)

The woman is unlikely to be held personally liable as a partner in an unincorporated business because a court is likely to infer corporate limited liability under the "de facto corporation" or the "corporation by estoppel" doctrine.

Generally, co-owners of a for-profit business that has not been properly incorporated are treated as partners in a partnership and are jointly and severally responsible for all business obligations. *See* Revised Uniform Partnership Act § 101(6) (defining "partnership" as "an association of two or more persons to carry on as co-owners a business for profit"); § 306(a) (specifying that "all partners are liable jointly and severally for all obligations of the partnership"); *cf.* Uniform Partnership Act § 15 (joint and several liability for torts, and joint liability for other obligations). Here, however, although the woman was a co-owner in a business for profit and thus a partner, a court would likely limit her liability because of the "de facto corporation" and "corporation by estoppel" doctrines.

Under the common law, courts have inferred corporate limited liability in cases of defective incorporation in two situations. First, under the "de facto corporation" doctrine, courts recognize corporate limited liability when there was (1) a colorable, good-faith attempt to incorporate and (2) actual use of the corporate form, such as by carrying on the business as a corporation or contracting in the corporate name. *See Business Organizations with Tax Planning* § 63.01; 1A *Fletcher Cyc. Corp.* § 215.

Second, under the "incorporation by estoppel" doctrine, most jurisdictions recognize corporate limited liability when a third party deals solely with the "corporation" and has not relied on the personal assets of the promoter. *See* Official Comment, MBCA § 2.04 (Example 4) (identifying situations where promoter represents that a corporation exists and enters into a contract in the corporate name, even though the promoter might know that no corporation has been formed). In these cases, courts have rejected the imposition of personal liability on equity grounds because the third party would otherwise receive more than originally bargained for.

Here, a court is likely to apply one or both of the common law doctrines to infer corporate limited liability in the installer's contract claim against the woman. Under the "de facto corporation" doctrine, the woman's mailing of the articles of incorporation to the Secretary of State constituted a colorable, good-faith attempt to incorporate. If the submitted articles had included the number of authorized shares, this would have led to a validly formed corporation. *See* MBCA § 2.03(a). In addition, the woman used the corporate form by entering into the employment contract in the corporation's name. She did this in good faith, apparently believing that the incorporation steps had been completed. There is no indication that the woman was aware that the articles of incorporation had been rejected.

In addition, under the "corporation by estoppel" doctrine, the installer's entry into the employment contract, which the woman signed as president of Solar Inc., is evidence that the installer understood that he was dealing solely with the "corporation" and was not relying on the personal assets of the woman. To allow the installer to hold the woman personally liable would create a liability that had not been bargained for. That is, the installer assumed the risk that the corporation (as happened) would not be able to fulfill the contract.

[NOTE: Some examinees might seek to analyze the woman's liability under the "promoter liability" rules that apply to contracts with a corporation that has not yet come into existence. *See* Restatement (Second) of Agency § 326 (1958) ("Unless otherwise agreed, a person who, in dealing with another, purports to act as agent for a principal whom both know to be nonexistent or wholly incompetent, becomes a party to such contract.") These rules, however, arise when both the promoter and the third party are aware that no incorporation has happened, though it may happen later. Thus, the "promoter liability" rules are inapplicable to the situation presented in this question given that there is nothing to suggest that the woman and the installer understood that the corporation had not yet been formed.]

Point Three (25%)

The man, as an inactive investor in the business, is not personally liable on the employment contract with the installer either under MBCA § 2.04 or as a partner in the unincorporated business.

Applying the defective-incorporation principles to the contract claim against the man, the man would not be liable under MBCA § 2.04 as he did not sign the contract with the installer and thus did not purport to act on behalf of the non-existent corporation. *See* Point Two(a).

In addition, even though the man as a co-owner in a business for profit may have been a partner in the unincorporated business, a court would likely infer corporate limited liability for the man under the "de facto corporation" and "corporation by estoppel" doctrines for the same reasons that limited liability is available to the woman. *See* Point Two(b). Generally, the "de facto corporation" and "corporation by estoppel" doctrines are available to all participants of the business, including those who are inactive. *See* 18A Am. Jur. 2d, Corporations § 196 (both active and inactive participants of a "de facto corporation" have the same rights and are entitled to the same protections). Similarly, the Official Comment to MBCA § 2.04, in reviewing the approach by courts in defective-incorporation cases, points out that inactive participants are generally not liable on pre-incorporation contracts. *See* Official Comment, MBCA § 2.04 (Example 5) (noting distinction between active and inactive participants in the case law, and stating that statutory liability extends only to active participants who purport to act on behalf of the corporation and "therefore relieves the latter of personal liability"). Therefore, the man here would not be personally liable on the installer's contract claim.

NOTES

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