

PAYMENT SYSTEMS

A LAW SCHOOL OUTLINE *by* CORBIN DODGE

Got Outlines?
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The use of **!!!** or **red text** in this outline indicates items that are likely to be on the exam.

Know them well.

BUILDING BLOCKS

Article 3= Negotiable Instruments - When this applies 3-102(a)

NEGOTIABLE INSTRUMENTS

Negotiable Instrument

§ 3-104

- An unconditional promise or order to pay a fixed amount of money, w/ or w/out interest or other charges described in the promise or order, if it:
 - 1) is payable to bearer or to order at the time issue or first comes into holder's possession
 - 2) is payable on demand **or** a definite time **&**
 - 3) doesn't state any other undertaking or instruction by the promisor ordering payment to do any act in addition to the payment of money, but it may contain
 - an undertaking or power to give, maintain, or protect collateral to secure payment,
 - an authorization or power to the holder to confess judgment or realize on or dispose of collateral,
 - a waiver of the benefit of any law intended to benefit or protect the obligor
- (b) **Instrument:** Negotiable instrument
- **Exceptions**
 - (c) An order that meets all the reqt's in (a), except (a)(1), **&** is a check → is a negotiable instrument **&** a check.
 - (d) A promise or order other than a check is not an instrument if, at the time it issued or first comes into possession of a holder, it contains a conspicuous statement, however expressed, to the effect that the promise or order is not negotiable or is not an instrument governed by this Article.
- **Note** if it's a promise.
- **Draft** if it's an order
either
If both apply → PEEI may treat it as
- **Check**
 - Draft, other than a documentary draft, payable on demand and drawn on a bank **or**
 - Cashier's check or teller's check
 - **May be a check even if described on its face by another term, such as "money order"*
- **Cashiers Check:** Draft in which the drawer and drawee are the same bank or branches of the same bank.
- **Teller's Check:** Draft drawn by a bank (i) on another bank **or** (ii) payable at or through a bank.
- **Certificate of Deposit:** Note of the bank. Instrument contains banks acknowledgment it received \$ **&** bank promises to repay
- **Travelor's Check**
 - Payable on demand **&**
 - Drawn on or payable at or through a bank **&**
 - Says "traveler's check" or a substantially similar term **&**
 - Requires, as a condition to payment, a countersignature by a person whose signature appears on it

2 TYPES OF NEGOTIABLE INSTRUMENTS

1. Note

§ 3-104(e)

- **Definition:** Promise to pay
- **2 Parties**
 - **Maker** - Person who issues the instrument **&** promises to pay) **&** EX: Student
 - **Payee** - Lender EX: Student loan lender
 - **Bearer** **rare* - Person who possesses a note that says "pay to the order of bearer"
- **General:** Note created by the bank → Is a CD

2. Draft

- **Definition:** Order to pay \$ aka written order

- 3 Parties

- **Drawer:** Person who creates the draft & orders the drawee to pay the payee EX: Person who gets car loan
 - **Drawee** EX: Bank who supplies loan
 - **Payee** EX: Car Dealership
 - Bearer might replace payee if they don't say who it is EX: "Pay to the order of bearer", or left blank
- **Applies:** Check

Clarifying the 3 Pieces of the Puzzle

- **Promise:** A written undertaking to pay \$, signed by the person undertaking to pay (maker)
- **Draft:** Instrument containing an order to pay \$
- **Order:** Written instruction to pay \$ signed by the person giving the instruction (drawer)

REQUIREMENTS: NEGOTIABLE INSTRUMENT**6 Requirements: Analysis Starts Here !!!****§ 3-104(a)**

- Writing
- Signed by maker or drawer (Symbol + Present intent to authenticate) (common issue=agent) **§ 1-201 (37)**
- Unconditional Promise **or** Order
- To pay a Fixed Amount of \$
- Payable on demand **or** Definite time
- Must contain to bearer **or** to order
- Contains no other undertaking or instruction *aka courier w/o luggage req't*

Unconditional Promise or Order

- **Rule:** Express conditions destroy negotiability (Under Art. 3) **!!!**
- Express condition to payment → Non-negotiable (not an instrument)
- Implied condition to payment → Negotiable if meets rest of req'ts

When, If, Unless !!!*"I'll buy this car from Dave & give him this promissory note"*

| Hypos | Are the following notes negotiable? |
|---|---|
| Put <i>drugs</i> in subject line | Negotiable |
| Put <i>on the condition that it's used to buy drugs</i> in the subject line | Not negotiable. A negotiable instrument may not contain any other undertaking or instruction as an express condition to payment |
| I promise to pay Dave \$5,000 if he gives me his car. | ? Bank can still cash it, however, it may pose an issue later (e.g. if it was taken to a check cashing place and transferred) |

Fixed Amount of \$

- **Rule:** Only the principal amount must be fixed **§3-106(b)(i)**
- **Doesn't Apply:** Interest
- **EX:** "Payable in 100 bales of cotton" → Not negotiable b/c not a recognized gov't currency. Foreign currency is ok though.
- **Not on Exam:** If doesn't say "payable only in euros" → Can demand payment in euros or USD

Payable to Order

- Payable to Order = Identified person
- Checks aren't req'd to have "payable to bearer" or "payable to order" language

Triffon v. Dillabough, 11 - Blank Amex \$ orders stolen from agent. People turn them into a store for \$ & store sells rights to Triffin. Issue is whether it is a negotiable instrument. If negotiable → He is a holder in due course. If not negotiable → It's a K

Remitter: Person who purchases an instrument from a bank that's payable to someone else**§ 3-103(15)**

- EX: You're a remitter if you get a cashier's check that's payable to a car dealership

Holder in Due Course (HDC)

likely on the bar

- **Definition:** Super-π. Somebody who takes for value & w/out knowledge of the problems associated w/ the transaction
- **Applies:** Negotiable instruments only
- **Key:** Is it a K or a negotiable instrument?
- **EX:** Seller gives you furniture & you give him a \$ note that will go to the supplier. If the seller gives you crappy goods & you cancel the note, the supplier may have a BOC claim but you have a defense. → Not a negotiable instrument
- Not a negotiable instrument → Still a valid document, but it's under K law (you pay only if seller performs)
- Negotiable instrument → Not under K law. Holder becomes a holder in due course.

Consideration Stated !!!

§ 3-106

- **Rule:** Can't have language that says "subject to" or "governed by" performance
- **Effect:** Has those words → Not negotiable

Courier w/out Luggage Requirement

- **General Rule:** Don't make any other promises other than a promise to pay \$ or a promise to order payment
- **Exceptions** **§ 3-104(a)(3)**

| | |
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| | |
| Problem 4, pg 16 Are the following notes negotiable? | <p>a. <i>(Date), I promise to pay bearer \$500, subject to the K I signed with Honest John today, (Signature)</i> Not negotiable. An instrument cannot contain language that says it is <i>subject to</i> or <i>governed by</i> performance § 3-106, Cmt 1</p> <p>b. <i>(Date), I promise to pay bearer \$500 as per the K I signed today w/ Honest John. (Signature)</i> Negotiable. A separate agreement affects only the parties thereto & not a DC. § 3-117</p> <p>c. <i>(Date), I promise to pay bearer \$500 on 1/1/2016. For rights as to prepayment & acceleration, see the K I signed on 9/25/2016, b/w the maker & the payee. (Signature)</i> Negotiable. § 3-106(b)(i)</p> |
| Problem 5, pg 16 | Checks mailed by an Insurance Co. are marked w/ <i>Void after 90 days</i> . Is this instrument technically negotiable? Not negotiable. <i>Hague</i> : An express condition to payment. Cts undecided !!! |
| Problem 6, pg 16 | <i>The collateral for this note is a security interest in the maker's art collection; for rights & duties on default, see the security agreement signed this day creating the security interest. Does this clause in the promissory note destroy negotiability?</i> Negotiable. May reference outside source to determine interest amount. Only the principal must be fixed. §3-3106(b)(i) !!! |
| Problem 8, pg 17 Do the following clauses in an otherwise negotiable promissory note destroy negotiability? | <p>a) <i>Maker agrees that signing this note also indicates acceptance of the contract of sale for which it is given</i> Not sure of the answer? It's a promise</p> <p>b) <i>Maker agrees & promises that if the holder of this note deems himself insecure at any time, he may so inform the maker, who will then supply add'l collateral in an amount & kind to be specified by the holder</i> Negotiable. §3-106(a)</p> <p>c) <i>Maker agrees to let the holder select an atty for the maker; at any time the holder directs, said atty is hereby given the authority to confess judgment against the maker in any appropriate Ct.</i> Negotiable</p> <p>d) <i>I have the right to make payments of Principal at any time before they are due. A payment of principal only is known as a "Prepayment." When I make a prepayment, I will tell the Note Holder in writing that I am doing so. I may not designate a payment as a prepayment if I have not made all the monthly payments due under this note.</i> Negotiable. Can promise to send notice that they're pre-paying.</p> <p>e) <i>Maker hereby grants the payee a security interest in the collateral described below</i> Negotiable. Avoid b/c too vague w/out having the K agreements</p> |
| Problem 9, pg 21 Are the following notes negotiable? | <p>a) <i>Payable 30 days after sight</i> Not negotiable</p> <p>b) <i>Payable in 11 successive monthly installments of \$2,414.92 each & in final payment of \$2,415.03 thereafter. The 1st installment being payable on the ___ day of ___ 20___, & the remaining installments on the same date each month</i></p> |

| | |
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| | <p><i>thereafter until paid. The blanks were not filled in.</i> ?</p> <p>c) <i>Payable on Nov. 8, 2016, but the holder may demand payment at any time prior thereto if he deems himself insecure.</i> Negotiable. Option to accelerate at will. §1-309</p> <p>d) <i>Payable when the sun comes up tomorrow</i> Negotiable if note is dated.</p> <p>e) <i>Payable on Nov. 8, 2016, but if my potato crop fails that year, payment shall be extended until Nov. 8 of the following year</i> Negotiable. Still a definite date. § 3-108(b)(iv)</p> <p>f. <i>Payable on Nov. 8, 2016, but the maker hereby reserves the option to extend the time of payment until he can pay w/out serious financial hardship.</i> Not negotiable. Only holder can extend (deposit when they want) § 3-108(b)(3)</p> <p>g. <i>Payable 120 days after my rich Uncle Al dies</i> Not negotiable. This is called a post-obituary note</p> <p>h. <i>Payable 100 years from today, but if my rich Uncle Al dies before this note is due, it shall become payable 10 days after his death</i> Negotiable. It's just like an acceleration clause.</p> <p>i. <i>Payable on my next birthday</i> Negotiable. But b-day must be built into the note.</p> |
| <p>Problem 10, pg 22 Do these promissory note clauses create bearer paper?</p> | <p>a) <i>Pay to John Smith</i> Payable to order and Not negotiable. A promise or order that is not payable to bearer is payable to order if it is payable to the order of an (i) identified person or to an (ii) identified person or order. A promise or order that is payable to order is payable to the identified person, § 3-109 (b).</p> <p>b) <i>Pay to the order of John Smith or bearer</i> Payable to bearer. If says "or bearer" it always wins. 3-109(a)(1), Cmt 2</p> <p>c. <i>Pay to bearer</i> Payable to bearer § 3-109(a)(1)</p> <p>d. <i>Pay to the order of Cash</i> Payable to bearer</p> |
| <p>Problem 11, pg 22 Do these clauses create order or bearer paper, or do they make the instrument non-negotiable for failure to create either?</p> | <p>a. <i>Pay to the order of (blank)</i> Payable to bearer.</p> <p>b. <i>Pay to John Does' estate</i> in a promissory note Non-negotiable. A person to whom an instrument is payable may be identified by name, ID #, office, or account number. § 3-110(a). For purposes of determining a holder of an instrument payable to an estate, the instrument is payable to the trustee, the representative, or a successor of wither, regardless of whether the beneficiary or estate is named, § 3-110(c)(2)(i).</p> <p>c. <i>Pay to the order of the President of the US.</i> Non-negotiable. A person to whom an instrument is payable may be identified by name, ID #, office, or account number. § 3-110(a). For purposes of determining a holder of an instrument payable to an office or a person described as holding an office, the instrument is payable to that person, § 3-110(c)(2)(iv).</p> <p>d. The drawer of a check drew a line through the words <i>the order of</i> that were printed on the check prior to the space for the payee's name. Is the check, as altered, negotiable? § 3-104(c)</p> <p>If the drawer of a check or the maker of a promissory note wants to destroy negotiability, what should be done? They should include a statement that <i>This is not a negotiable instrument</i>, §3-104(d).</p> |

THE NATURE OF LIABILITY OF THE PARTIES

Endorsement: Can be blank or special

Endorser: 1st person to endorse it

Check: Drawee is the bank

THE UNDERLYING OBLIGATION

Rule:

- Landlord-tenant lease → Underlying obligation is the lease
- EX: I put check in mail b/c you mowed my lawn → It gets lost → You can sue me for breach of K/Unjust enrichment
- That's the underlying obligation, but sometimes it can be suspended, so you wouldn't be able to sue yet § 3-310(b)
- EX: Buy car → You execute a sales K for the car → Then you sign a note to finance the car → The note suspends the underlying obligation to pay the sales K immediately
- 3-310(b) = ordinary instrument.
 - If it's a check. It suspends the obligation until it's dishonored or discharged
 - If it's a note, it suspends the obligation until it's dishonored or paid off
- 3-312 → Provides a solution to the problem

Fifth Third Bank v. Jones, 109 Bank reserved a check from a 3P to pay off a default debtors mortgage. Presumed it was a cashiers check, b/c of the banks procedures. The debtors underlying obligation to pay the mortgage was suspended under § 3-310(a) b/c the cashiers check is treated like cash [Bank got the check, lost it, & can't get payment from the issuing bank. The debtor's underlying obligation is discharged b/c title passed to the bank]

- 3-312 → Provides a solution to the problem. It gives a procedure for the bank to follow → Under penalty of perjury we have lost the check (declaration of loss)→ Bank must prove what check said → Bank must wait 90 days

Destruction of Note

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| Problem 44, pg 108 | What's the underlying obligation? Lease Agreement. The note, like a check issued to pay suspends the underlying obligation |
| Problem 45, pg 108 <i>Same</i> but suppose Aunt Fran paid her rent by giving a cashier's check to Simon. The check was drawn by Octopus Bank (ONB) on itself (the very def. of a cashiers check § 3-104(g)). Simon took the check to ONB & was dismayed to discover that ONB had failed & was now closed. He returned to Fran & demanded the rent money. | What should she tell him? Her underlying obligation was discharged unless there was an agreement to the contrary (?) § 3-310(a) |

Rule: Underlying obligation discharged by a voluntary, intentional act (focus on intent)

Doesn't Apply: Accidental destruction

EX: Tear up rent check

EX: Falls in shredder

| | |
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| <p>Problem 46. Pg 108 When Fran told Simon that she wasn't liable for the rent a.l.a. the note was outstanding, he got it back from the bank and tore it up.</p> | <p>May he now sue her for the rent even though the note has not yet matured? 3-3604, 3-310(b)(4), 3-309 Creditors subjective intent irrelevant)</p> <p>If the cancellation had been a clerical error, what result?</p> |
|---|--|

ACCORD & SATISFACTION

Requirements

- 1) Debtor must tender instrument in good faith relieved
- 2) Claim must be *unliquidated* (something hasn't happened yet) or Subject to a *bona fide dispute* (good faith) job
- 3) Paid
- 4) *Add'l Req't*: Conditions must be conspicuous

*not in book **§ 3-311**
EX: If I give you this & you cash it → Debt is

EX: You did a bad

Effect: If 1st 3 req'ts are met → Claim discharged, unless...

Exceptions

- ~~1) Law Clocks (not on exam)~~
- 2) Returned Payments amount

EX: They cash check, but write check back for same

Ward v. Federal Kemper Insur. Co, 113 - Who holds the \$7.50 when insurer over-refunded a customer w/ a check? A check isn't an assignment of funds. It just gives you the right to get it. Here, Ward (the insured), never cashed it → so not negotiated. Thus, the overpaid refund was never assigned to Ward. He's not liable.

LIABILITY ON THE INSTRUMENT

LIABILITY OF MAKERS & INDORSERS

Overview

- Simply signing ones name (on a note, a check) can obligate them
- Irrelevant whether making that note our or indorsing
- Sign → You are the maker who is liable for whatever the note says,
- **Signing:** Present intention to authenticate

§ 3-401(a)

Obligation of Issuer of Note

§ 3-412

- PEEI → Can sue the issuer (bank) or the maker (more common)
- If endorser paid the instrument → Maker also has duty to pay the indorser
 - EX: Maker gives note payable to A (payee). A indorses to B. → A must pay B, but A can also go after the maker if maker doesn't pay her.

Person Entitled to Enforce the Instrument (PEEI)

§ 3-301

- **Holder** (almost always this one)
 - Order paper → become holder b/c endorsement & possession
- **Non-holder in possession of it, w/ rights of a holder**
 - **Reason:** Transfer of an instrument vests in the transferee any right of the transferor. Irrelevant if it was a negotiation **3-203(b)**
 - **BOP:** On transferee (higher burden than a holder)
 - EX: Subrogation. In accident b/c hit by car. InsurCo pays. But if I sue the person who hit me, my InsurCo is now subrogated to my rights. They step into your shoes to collect the \$ from the lawsuit that they paid. They are in possession as a non holder b/c of the underlying obligation
 - EX: Transferee as a holder. A is payee of the note from B, the maker. It's order paper b/c says "pay to the order of". A transfers it. A is holding order paper, not payable to B. B has Alice's rights as a holder but must...

- **Person not in possession, who's entitled to enforce it**
- Usually O of a lost instrument

see § 3-412
EX: If A lost the check

Joint & Several Liability; Contribution

§ 3-116

- If you sign a note as a maker w/ several people there...you could be liable for the full amount, not just a fraction of it.
- However, if you had to pay <your share → You have a right to contribution to recover their proportionate share (max that you can sue each for)

Mortgage: A consensual lien to secure the loan

- **Mortgagor:** Homeowner
- **Morgagee:** Lender
- **Perfection:** When mortgage is properly recorded
 - **Effect:** Lender probably won't lend against it b/c its fully encumbered
- **Underlying Obligation:** Pay mortgage
 - **Suspended by:** Promissory note for X# yrs

INDORSERS OBLIGATION

- **Rule:** A person who signs an instrument is presumed to assume a liability for that instrument § 3-204(a)
- **2 Purposes you may negotiate**
 - 1) Indorsing for the purpose of negotiating
 - 2) Taking liability for another as a surety or guarantor
 - Amomolous indorsement
 - EX: Pay to order of John. John signs his name. Then Dave signs "*as guaranteed, Dave*"
 - No point in doing that

- Obligation of Indorser (creates their liability)

§ 3-415

- **Rule:** If instrument dishonored, the indorser promises to pay it
- **Obligation owed to:**
 - PEEI or
 - **A subsequent indorser who paid the instrument !!!**
- EX: Bob → Jill → Sally → Dave → Tank to US Bank who presents it to → Wells. Wells dishonors the check b/c there's not enough funds
 - Thus, Dave, Sally, and Jill are subsequent indorsers and are liable. Look Backwards for who to sue !!!
 - Dave can recover from Sally
 - Sally can recover from Jill. She can't recover from Dave.
- **3 Conditions**
 - Presentment & EX: presented to bank
 - Dishonor & EX: Bank dishonors
 - Notice of Dishonor

LIABILITY OF ACCOMMODATION PARTIES

LIABILITY OF THE PARTIES: ACCOMMODATION PARTY & SURETYSHIP DEFENSES

Accommodation party must be

- 1) in writing &
- 2) not a direct beneficiary
- EX: Sign your brothers car loan as an AP → Still an AP b/c no direct benefit, even if relieved of driving him around

Makers Liability

- **Rule:** A maker must pay a note according to how it appeared when they signed it
 - Makers liability can change based upon how they signed the instrument.
 - Liability can be waived by agreement

Liability in Capacity of Unclear Signature

EX: Says agent but not

to whom

- Parole evidence is admissible to identify the party for which an agent signed (when unclear on the face of the instrument), *Munchera*, 164
 - Failure to give notice of dishonor > ???
 - For checks > must give notice to ___ ??? ___ once the PEE has been notified of dishonor
 - A collecting bank must notify the customer on the **next business day** if a check is **rejected**
 - Still liable even if there's an excuse
 - If a person has **notice of dishonor** they are ___ ?? ___ EX: Stop payment
- § 3-605(d) If the **principals obligation** is **secured by collateral** and the **creditor impairs that collateral** > then the secondary obligor is discharged as to the amount of that collateral.
- The secondary obligor must waive their rights to be liable (to not be discharged) **§ 3-605(f)**
 - This is why §3-605 rarely comes up in practice. Good attys ensure the secondary obligor DOES waive their rights and thus could be liable.

2 PRIMARY OBLIGOR'S (CO-MAKERS) WHO ARE JOINT AND SEVERABLY LIABLE TO EACH OTHER ARE ALSO SECONDARY OBLIGORS § 3-605, CMT 3

| | |
|-------------------|---|
| | |
| Problem 57 | <p>§ 3-605(d) If the principals obligation is secured by collateral and the creditor impairs that collateral > then the secondary obligor is discharged as to the amount of that collateral.</p> <p>The secondary obligor must waive their rights to be liable (to not be discharged) § 3-605(f) This is why §3-605 rarely comes up in practice. Good attys ensure the secondary obligor DOES waive their rights and thus could be liable.</p> |
| Problem 58 | <p>George & Martha are co-makers + primary obligors on the note, but they're joint and severally liable to each other, which also makes them secondary obligor's to each other § 3-605 , cmt 3, last paragraph 4th</p> <p>George is discharged, however he could go after his "right of contribution" from Martha b/c she' s joint severally liable to him.</p> |

DRAWERS LIABILITY

The Non-Bank acceptor

- *Norton v. Knapp*, 157
- **Facts:** [π drawer] delivered unpaid goods to [Δ drawee, Knapp]

Acceptance occurs when the bank certified to check as presented

- Means the bank accepts responsibility (the funds of been reserved)

Requirements

- 1) In writing
- 2) On instrument
- 3) Signed by drawee bank
- 4) *Notified holder* ???

A bank has NO liability to the HOLDER of a check **unless it accepts the draft** (it only has it to his customer)

Gayton Pet. V. Mixson, 160

- **Facts:** π supplied fuel to Δ. Owed bank \$7,000 for promissory note. π took Δ's checks to deposit but they were rejected for insufficient funds. Repeats several times. Then Mixson goes bankrupt.
- **Holding:** π had no COA against the bank. There was no assignment of funds to him.
- **Rule:** A bank is not liable to the holder of the check unless it accepts the draft. (It didn't)

Liability of Drawer; liability of Indorser

- {picture}

- Then, Bob can go after dave (drawer) and Paul (indorser)

Mundaca Investments v. Finch, 164

- **Facts:** Δs (trustees of a realty corp) buy condos using mortgages from Dartmouth Bank. They signed as “borrower” for the trust fund but added *trustee* by hand. Δs claim they’re not personally liable b/c they signed as representatives.
- **Holding:** Δs could be held liable b/c they signed their individual signatures. They should have signed “as representative”

DRAWEE LIABILITY

General Rule: Drawee is not liable if the bank hasn’t done anything

Exception: unless the bank accepts it [means a certified check]

- 1) In writing
- 2) ?
- 3) ?
- 4) ?
- 5) ?

The only time the drawer can recover is when the bank commits a **wrongful dishonor of a check**, in which case the drawer is entitled to **proximate DAS**

A [certified check or cashiers check or tellers check] given in payment of an obligation discharges the underlying obligation **unless there’s an agreement to the contrary** § 3-310(a)

An [uncertified check or note] given in payment of an obligation **suspends** the underlying obligation § 3-310(b)

- ... until there’s notice of dishonor or § 3-310(b)(1)
- Discharges the obligation (up to the amount of the instrument) § 3-310(b)(2)

If a person is both [obligee] & [a PEEI], but they **no longer have possession** b/c it was **lost, stolen, or destroyed** means the obligation may not be enforced (up to the the amount of the instrument) & (to the extent of the obliges right against them)

| | |
|----------------------------------|---|
| <p>Problem 66, pg</p> | <p>Does Sue (payee) have a COA against the bank? No b/c the bank did not accept the draft. A drawer bank has no liability to anyone except it’s customer unless it accepts the draft. The mere fact that a person is named as paid doesn’t subject the bank to liability.</p> <p>Does Sue (payee) have a COA against Sam? Yes, b/c the drawer is still obligated to pay the instrument (drawers liability). However, if the bank accepted the draft Sam would be discharged.</p> <p>Does Sam have a COA against the bank? Only if he can show 1) it’s properly payable & 2) his account had sufficient funds. He would then be entitled to receive proximate cause DAS & consequential DAS (if they had notice). Rarely, he could get punitive DAS. This is the only time when the bank would be liable to its customer.</p> |
| <p>Problem 67, pg 162</p> | <p>Is that a dishonor so that the church should give...? No, per § 3-409(d), cmt 4. A bank is not required to certify check. A banks refusal to do so is not a dishonor. Failure to certify is never a dishonor <u>unless</u> there was a prior agreement (in which case it’s under K law-separate COA)</p> <ul style="list-style-type: none"> - Cash the check - § 3-414(c) No, b/c the certification of a check destroys liability of all the parties. - § 3-409(d) failure to certify is never dishonor unless they have a prior agreement (so it’s a separate cause of action under K law) |

| | |
|---|--|
| <p>What if seller draws a draft on the buyer? Seller draws a draft on the buyer (instead of the bank) (So here, buyer is also the drawer). Assume seller gave the check and local bank paid it before it took the check to the collecting bank. Thus, the collecting bank is now dealing with the buyer. Buyer response "I don't have \$10,000 now but I promise I'll pay."</p> | <p>Result? The collecting bank is the PEEI. It would accept the draft and buyer would then sign. The bank accepts full liability.</p> |
|---|--|

LIABILITY OF THE PARTIES: SIGNATURES BY AGENT

Representative (Agent): Person w/ power to act for another
- Under Art. 3: **Principal**= person **Agent** = representative

§ 1-201(2-3)

Exam Analysis

- § 3-401(a)—*Is it a valid signature?-- is the starting point for liability (start essay here). Then go to §3-402 and so on...*
- **Issue:** Was the agent authorized to sign for the representing person under §3-402?
- **Rule:** A represented person is liable, even when the represented persons name is not on the instrument

LIABILITY OF PRINCIPAL

Rule: When an agent is authorized to sign for the principal, a principal is liable for anything his agent does, regardless of whether the principals name is on the instrument

Exception: Principal not liable if the holder had notice that the agent was not signing in a representative capacity

3 Types of Authority (Express, Inherent, Implied)

- **1) Actual Authority** - Authorized agent reasonably believes he possesses the authority for the power to act
- **2) Apparent Authority** - 3P reasonably believes agent possesses the authority. Based on the principle of that agent.
- EX: "Joe my assistant takes care of everything I need"
- **3) Implied/Inherent Authority** - Authority is implied by level of position. *Cloak Authority* i.e. CEO, president, partner

2 Scenarios

- 1) an agent is **NOT** liable if he is **authorized to sign** and its shows **unambiguously**
i.e. Agent signs and principals name is on the check
- 2) If the agents signature is **ambiguous** and he was **not authorized** to sign → the agent **IS** liable **unless** he proves the **original parties had notice (HDC)**.
- HDC must know you acted as an agent & didn't want to be personally liable

LIABILITY OF REPRESENTATIVE

Rule: A signor is not liable if the signature is **authorized** and it **indicates their agency status**

Rule: A representative/agent is personally liable if they're **not authorized to sign** or if they **exceed their authority**

Effect: Signature doesn't operate as a representative person signature (none of the authority types present)

Tip: Always make sure the signature line shows they're signing as the agent.

Authority Rule: If HDC takes the instrument → They're liable

So you could argue as a defense: *Do you remember our conversation when U signed theis? We said we didn't know who the ___ was & I'd sign my name until we figured it out.*

Methods v Seale

- Ct says the instrument indicates they signed on "behalf of.."They lost b/c they must show proof of subjective intent

| | |
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| Problem 68, pg 183 | Is Bigley (the principal) obligated on the note? Yes. |
|--------------------|---|

| | |
|--|---|
| Finch (agent) signed for Bigley (principal): "J Pierpoint Finch, Agent" w/o designating Bigley's name on the instrument. | <p><i>Is it a valid signature under §3-401?</i> Yes. A person may be liable if they are represented by an agent or representative who signed the instrument and the signature is binding on the represented person under § 3-402.</p> <p><i>Is the signature binding under §3-402 [Signature by Representative]—i.e. Did Finch have authority as Agent?</i> Yes. Finch's signature is binding on Bigley. A principal is liable for the signature of his agent even if the principal's name is not designated on the instrument.</p> |
| In-Class Example Simon owns Simon Industries. | <p>Is Simon liable if a note bears the signature <i>Simon Industries</i>? No.</p> <p>What if Simon's name was on the instrument? Maybe. He wouldn't be liable if the signature unambiguously showed that it was 1) made on behalf of the principal 2) who is identified in the instrument.</p> <p>In § 3-402(b) He is liable unless the holder had noticed that the agent has not signed in a representative capacity</p> |
| Problem 69, pg 164 | Is ___ liable to Wickets National Bank? Wickets is a HDC. Thus, under the Authority Rule, Wickets will be liable if they accept the instrument, § 3-402(b)(2) |
| Problem 70, pg 165 | <p>1) Is John liable as a HDC? Yes, b/c it was his personal signature</p> <p>2) Unclear. It might be under § 3-402(b)(2) if judge says it is unambiguous. However, it may be determined to be ambiguous b/c it doesn't say he was signing as an agent or president or it might be under §3-401 if judge thinks its unambiguous i.e. <i>Money Corp., John Smith</i></p> <p>3) Not liable. The agent proved he signed in his capacity</p> |
| Problem 71 | §3-402(c), Cmt 3 This is the exception which only deals w/ ??? |

| | |
|---------------------------|--|
| | |
| Problem 47, pg 118 | <p>a. May he defend on the basis that Anderson should have sued all 3 of them? No. He is responsible for the full amount b/c the liability is joint and several. § 3-116</p> <p>b. If Anderson wins can he sue Blinkin for \$1,000? Yes, he has a right of contribution. § 3-116</p> <p>c. for \$2,000?No. He can only recover \$1,000, the max proportionate share Blinkin was responsible for. § 3-116</p> |
| Problem 48, pg 120 | <p>a. Does Harry's liability as the maker of the promissory note run to VFC? It's order paper b/c Rowling was the payee and never indorsed it → Liability runs to a PEEI § 3-412 → The only way you can get liability of the maker is if they have possession of the note (or its lost). It's a strict req't of possession. Possession is proof of ownership. Copies are usually insufficient. Since Rowling doesn't have possession and it wasn't lost, they are not liable. § 3-301</p> <p>b. Is the copy of the promissory note valid against Harry?</p> <p>c. *Assume Rowling Bank lost the note. What can Rowling do? § 3-301 (#3) → but if VFC can meet § 3-309 req'ts, they can enforce the note. Thus, Rowling would need to go to Ct and prove the scenario, by proving these 4 things:</p> <p>§ 3-309 Requirements for Enforcement of a Lost, Destroyed, or Stolen Instrument</p> <ol style="list-style-type: none"> 1) Rowling must prove it was the holder (had possession of the note) & had rights to enforce when it disappeared 2) Prove they didn't transfer it (e.g.: It went to shredder) 3) Not lost, stolen 4) Prove terms of the instrument <p>However, if he succeeds he won't be paid immediately → The Ct must wait 90 days before entering a judgment against Harry, b/c it must ensure Harry is adequately protected against the possibility that it could be cashed again. (Adequate Protection Doctrine). → Then the Ct can make Harry pay Rowling Bank.</p> <p>d. Is Harry liable on the mortgage K? § 3-310, Cmt. 2 (merger rule)</p> <p>e. What are the equities here? If Harry pays VFC does that put him at risk?</p> |

| | |
|--|----------------------|
| | If a Ct holds |
|--|----------------------|

HOLDER IN DUE COURSE DOCTRINE

ACQUIRING HOLDER IN DUE COURSE (HDC) STATUS

HDC if:

- Instrument appears authentic &
- Holder took the instrument for value in good faith w/o notice that it's overdue, been dishonored, or that there's an uncured default, w/o notice it has an unauthorized signature or was altered, w/o notice of a § 3-306 HDC claim to an instrument & w/o notice any party a defense of a recoupment claim

§3-302

no evidence of forgery, etc

But not if

- Predecessor in interest has HDC rights **or**
- Instrument taken by creditors in bankruptcy **or**
- Bulk transaction not in transferors ordinary course of business **or**
- As the successor-in-interest of an estate or organization **or**
- Instrument states the rights of a holder/transferee are subject to the claims or defenses the issuer could assert against the original payee **§ 3-306(d)**

General

- HDC is a super-π
- HDC status is subject to [Bankruptcy | Infancy | Fraud | Illegality/Duress] regardless of defense. The only real defenses are listed in 3-305(a)(11)

ELEMENTS OF A HDC

HDC = Holder + Value + Good Faith + w/o Notice

1. HOLDER

To be a HDC you must be a **holder of a negotiable instrument** (requires **possession + bearer paper**)

Exam Tip

- If it says they *received* a negotiable instrument → Assume req'ts met
- If it says they ??? a note → then establish all elements of a negotiable instrument

2. VALUE

Value is a performed promise !!!

Payment of a standard claim is ok. A performed promise is ok for an executor promise. Irrevocable commit lean off the instrument aren't on exam !!!

6 Components

- 1) Protection of promise is value (requires **performance**)
- 2)
- 3)
- 4)
- 5) Value is an irrevocable commitment to a 3P (not on exam)
- 6) 4-210 Security interest of collecting bank) & 4-211 (bank gives value for HDC purposes)
 - Value in banking Channels
 - Thus is how a bank can become a HDC

General

- **UCC:** Value is related to, but not identical to consideration. It's what they GAVE (not what they received)
- **Key Issue:** Did Someone give value?
- If no value was given → did holder give something up?

- **Sample Exam Answer:** Here, the holder gave value b/c he _____. Gave payee a \$__ note, or b/c he promised to ____ and did it.

Remember: Person Entitled to Enforce an Instrument (PEEI)

§ 3-301

- Holder **or**
- Non-holder in possession who has the rights of a holder **or**
- Person not in possession who is entitled to enforce the instrument visa 3-309 (lost, stolen, destroyed) or 3-418(d) (paid or accepted by mistake)

Can be a PEEI even if not the owner or is in wrongful possession of a lost or stolen instrument

Remember: Consideration vs Value

- A promise to pay under K law **or**
- A promise to pay in exchange for value purposes means it has been performed (paid) → Gives it value

Special Rule for Collecting Banks

- **Rule:** Grants a collecting bank a security interest in the instrument
- **Purpose:** Incentive for banks to loan \$ by allowing it to draw uncollected funds from a customers account. Banks take on a risk when they loan out \$ b/c it could be liable if the note is dishonored
- **This is in addition to § 3-303**

| HDC > VALUE REQUIREMENT | | |
|---|--|--|
| <p>In-Class Example Allen bought a TV but never received it.</p> | <p>What if Allen failed to pay? Rip U' Off can give up the note as a security interest in the bank.</p> | <p>Allen (Note) → Rip U' Off TVs → Finance Co HDC has nothing to do w/ whether consideration was given here... ...but it matters here. Was value given?</p> |
| <p>Problem 21</p> | <p>What is the basis of the wifes claim? A holder takes free of the instrument, § 3-306. Go through the analysis: Is he a holder? Yes, b/c it's a check Has he given value?</p> | |
| <p>In-Class Example Lawyer takes \$. Jane sues, asserting rights as a HDC.</p> | <p>How could Jane get the money? She must prove she's a HDC. How could the lawyer retain the money? He must prove he's a HDC.</p> | |
| <p>Problem 22</p> | <p>a) Here, Pierce Finance is the holder. The holder gave value b.c it promised to pay \$2,200/month and it did. Thus Pierce Finance is not liable b/c no value was involved (i.e. they paid the note)</p> <p>b) Assume instead that Pierce Finance purchased the note for \$20,000 and is paying in installments, but it only paid 2 installments totaling 15,000. What result? See § 3-301 PEEI. Then apply the formula to find out if value was given. FORMULA NOT ON EXAM</p> | <p>Zach → Fillmore → Pierce Finance \$23,000 Note Sold the note to...</p> $\frac{\text{Amount Payable} \times \text{Value of Performance}}{\text{Value of Promised Performance}} =$ $\frac{(\$23,000 \times \$15,000)}{\$20,000} =$ $\$17,250$ |

3. GOOD FAITH

Honesty in Fact (subjective) + A reasonable good faith belief (objective)

§ 3-103(a)(6)

4. W/O NOTICE

PART I.

The Reasonable Person Standard

§ 3-302(a)(1)

- Look at the face of the instrument to determine if the instrument appears forged, dishonored, is overdue, or if there was notice of any claim to the instrument

A Person has Notice if they have:

§ 1-202(a)

- Actual Knowledge &
- Received Notice &
- Facts & Circs indicate they had reason to know the instrument was **forged, dishonored, is overdue, or if there was notice of any claim to the instrument**

PART II.

A person who has notice that the instrument has been [see above] is not a HDC.

Overdue

If they see the instrument is due on X date & its later than that date → They have notice → Prevents HDC Status (Can't be a HDC)

Acceleration: Notice of an event that accelerates the maturity date prevents HDC status

Demand Instruments can be called upon at anytime for payment. Check becomes overdue 90 days after it's due date → prevents HDC status

General Rule: A HDC takes free of ordinary K defenses *subject to* only real defenses

Remember...

To be a HDC, a person must be a holder of an instrument of value that was given in good faith, and without having notice that the instrument was forged, dishonored, is overdue, or that there was any claim to the instrument. If it is bearer paper they must have possession. If it is order paper they must have lost something of value. ???

Notice of Breach of a Fiduciary Duty

Notice of Breach of a Fiduciary Duty

§3-307(b)

- Made payable to the fiduciary in their capacity **or**
- Made payable to the fiduciary personally **or**
- Made payable to the fiduciary directly to the taker **or**
- Made payable to the fiduciary as payable for personal debt

Most Common: Goods paid by a corporate check for personal stuff

Reason: Financial institution has notice of a claim & therefore can't be a HDC

!!! ON EXAM

A Person has notice of a breach of a fiduciary duty (which =notice of a claim) when:

- 1) Instrument taken for value from a fiduciary
- 2) Knows they're a fiduciary & aka w/ knowledfe
- 3) Represented person (aka principal) makes a claim of breach of a fiduciary duty
- *Then they can't be a HDC!*

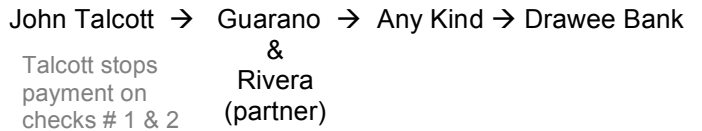
Pay to the order of Dave Hage, V.P., L.L.C → They have notice of that benefit. If he uses it for personal benefit → Then they have notice of a breach of a fiduciary duty and he can't be a HDC

Jones v. Approved Bancredit, 88

- A buyer-transferee can be denied HDC status if they're too closely connected to the seller-transferor
 - i.e. you can't be a HDC for an in-house finance/credit co.
 - i.e. Sears finances a dryer they sell you → Can't be a HDC
 - Protects the good faith buyer

Any Kind Checks Cashed v. Talcott

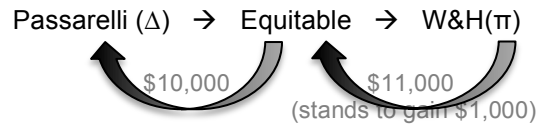
- **Facts:** Any Kind issued a complaint against Guarino & Rivera b/c they scammed Talcott into writing the checks. Any Kind Claims it's a HDC. Talcott defended that Any Kind wasn't a HDC b/c his obligation was nullified by their illegal acts
- **Was Any Kind a holder?** Yes
- **In Good Faith?** Disputed, so analyze:
 - **Honesty in Fact?**
 - **Reasonable Good Faith Belief?**



- **w/o Notice?** Yes. A holder takes *subject to* any claims or defenses of another if they are not a HDC. Use the reasonable person standard to determine whether they have inferred that Talcott had a defense.

Winter & Hirsch v. Passarelli, pg 52

- Passarelli has § 3-402 makers liability b/c he failed to pay the note. Since W&H paid equitable before Passarelli was paid the \$10,000 by Equitable, they treated Equitable as a co-originator of the note, which violated usury laws



Discounts: A steep discount, alone, is not enough to deny someone HDC status (this is the time value of \$)



Corrections: A correction on the face of an instrument is not enough to deny HDC status

Notice Instrument is Overdue

Notice that a note has been dishonored or is overdue -> Can't be a HDC !!!

§ 3-302

When is an instrument overdue? Upon non-payment of an installment

When is an instrument overdue? The possibilities:

§ 3-304(b)

- Installments aren't accelerated → Upon 1st non-payment of an installment
- Payment not accelerated → 1st day after due date
- If accelerated → Day after the accelerated due date

| HDC > NOTICE REQUIREMENT | |
|--------------------------|---|
| Problem 25 (easy) | The lender is not a HDC b/c it doesn't have possession of the instrument. Following the analysis: it paid value, there was good faith, & they never transferred it so the widow has a defense to liability. |
| Problem 26 | Business Corp /s/ Smith, Treasurer → AmEx Is AmEx a HDC under §3-306? |

| | |
|-------------------|--|
| | <p>If AmEx is a HDC → they <i>take free</i> of any claim to the instrument If AmEx is not a HDC → they take <i>subject to</i> any claim to the instrument</p> <p>Amex is a holder of an item that has value which was given in good faith. The issue is whether AmEx had notice that a fiduciary duty had been breached. HDC status is barred when a person has notice that an item was <i>taken in payment of debt...known to be the personal debt of the fiduciary</i>, §3-307(b)(4)(i). Thus AmEx is not a HDC b/c it took the item w/ notice that Smith had used it to pay his personal debt.</p> |
| Problem 27 | <p>Is something wrong on the face of the instrument? The date was crossed out and corrected Is this an alteration? No. A correction on the face of an instrument is not enough to deny HDC status. §3-302(a). They're common.</p> |
| Problem 28 | <p style="text-align: right;">Maker → Ace Finance → BTB Note But note had <i>Missed</i> <i>Paying 1st Installment</i> written on it</p> |
| Problem 29 | <p>Checks are normally negotiated w/in 90 days. Dan → Dr. Paine → Depository Bank → Drawee Bank If it's overdue and hasn't been handled w/in 90 days → they had notice that it was overdue → Can't be a HDC</p> |
| Problem 30 | <p>The <i>Forgotten Notice Doctrine</i> is no longer applied (doesn't exist anymore). The bank had notice b/c she called and instructed them not to accept it, therefore the bank can not be a HDC</p> |
| Problem 31 | <p>Is Friendly a HDC? No. Friendly was never a holder b/c it was never negotiated. Unless otherwise agreed, if an instrument is transferred for value & transferee doesn't become a holder b/c of their lack of indorsement...§3-203</p> <p style="text-align: right;">Earth → Trator → Friendly \$2,000 Instrument transferred but not negotiated</p> |

THE SHELTER RULE

DRAWING

Policy: You're only barred if you're engaged in fraud

Gives a non-HDC the rights as a HDC (even though they're not one)

Comes from CL concept that transfer of an instrument effectively convey transferee all rights the transferor had

Allows transferee to step into the shoes of the HDC (even if gave no value) A person regains his original status when the reacquire an instrument

Any holder, regardless of whether they're an HDC, can recover UNLESS they're a HDC

It's only when they raise a defense that you must investigate whether they're a HDC

Triffon v. Somerset Valley Bank

Drawing

Holding: Since the check cashing agency was a HDC, Triffon is sheltered

Remember, notice that a check has been dishonored bars HDC status

Remember, a person is not liable on an instrument if they never signed the instrument

Thus, forged → not liable. There is no liability on a forged instrument

If there's any evidence of forgery or unauthenticity → Can't be a HDC

| | |
|-------------------|---|
| Problem 32 | <p>Is Jessica a HDC? No. Jessica is sheltered to Alfreds rights as a HDC, but she is not a HDC b/c she didn't pay value for it. 3-203(b)</p> |
| Problem 33 | <p>Is Lorenzo an HDC? Yes. Lorenzo is sheltered as to Alfreds (Jessicas?) rights. He can go after Manny</p> <p>Could Lorenzo recover from Alfred? Yes, he can sue for indorsers liability</p> |

| | |
|-------------------|---|
| | Can Alfred make a CL defense to lack of consideration? Yes. This is the distinction , b/e being a HDC vs. a sheltered holder. Lorenzo (?) is only sheltered as to his rights against Manny drawing |
| Problem 34 | Can Portia recover from Alfred? Yes b/c she's a HDC. Alfred would not be able to use a defense of lack of consideration. He would only be an HDC if her bought the instrument back from Portia |
| Problem | |
| Problem | |

FREEDOM FROM CLAIMS AND DEFENSES

DEFENSES AGAINST A HDC

The rights of a HDC is subject to **real defenses**, but **not claims** **MUST distinguish b/w claims & defenses on exam !!!**

Real Defenses Against a HDC

§ 3-305(a)(11)

- Infancy
- Duress (Usually requires some sort of physical action)
- Lack of legal capacity or illegality
- Fraud
- Discharge in bankruptcy

If § says it's void → It's a real defense

Ordinary K Defenses Against a HDC

- Breach of K
- Lack of Consideration
- Waiver
- Estoppel
- Etc

Defenses must fall under Art. III or K law
Unrelated claims may not be asserted

Claim in Recoupment

- Must be associated w/ same instrument &
- Not a real defense against a HDC &
- Usually in counterclaims

i.e. DAS & you sue

INFANCY

- A minor who makes a claim on an instrument will fail against a HDC
- Look to state law to determine the age of capacity to K.

e.g. 16, 17, 18

Chemical Bank v. Pic Motors

- **Facts:** π claims dealerships false inventory reports Siegal personally guarantees as *guarantor of payment* (not collection). He sold the company's interest to Δ, retaining the guarantee (the consideration) as partial repayment
- **Holding:** Bank had no obligation to preserve or protect the collateral
- **Drawing**

Londong Leasing Corp v. Interfina, 142

- **Facts:** Δ defaulted. Did Evans consent to be personally liable?
- **Holding:** Evans consented. As the President, he controlled the corp. Thus, his consent as primary obligor of the corp acted as a personal guarantee.
- **Drawing**

FRAUD

A HDC takes *subject to* certain defenses, such as fraud in the factum

FDIC v. Culver, pg 76

| ORDINARY FRAUD | FRAUD IN THE FACTUM |
|---|--|
| Victim meant to incur liability <u>but</u> they were induced by fraud. | Victim never intended to incur any liability |
| e.g. signed note intentionally & knew they would incur liability, but it was induced by fraud | e.g. "OJ, can you sign this?...Haha it's a note!" → Void b.c no agreement ever arose |
| | Requirements 1) Signed endorsement w/o knowledge of its character or essential terms 2) <i>Excusable Ignorance</i> : No Knowledge or reasonable opportunity to learn of its terms |
| | Can't raise a defense if they <i>should have known</i> Didn't read → Can't recover Blind → Might recover |

ACTIONS FOR RESCISSION

You are liable for checks you endorse, even if you're a minor.

§ 3-202(a)

A negotiation may be rescinded, but **not** against a HDC .

§ 3-202(b)

Remember, a HDC is subject to **real defenses**, but **not claims**

ILLEGALITY

See *Air Support v. Herrmann*, pg 38

If the law says the **illegality of an obligation nullifies that obligation**, then that defense may be used against a HDC

§ 3-305

Focus on the exact language of the §. If the § says it's void → It is void.

Kudzie v. 103^d Currency

Exchange

Drawing

Example Exam Answer: "The states would each balance whether public health & welfare, such as ensuring _____, is more important than the negotiability of an instrument. [Discuss both for full points]"

DISCHARGE OF THE OBLIGOR IN INSOLVENCY PROCEEDINGS

| | |
|-------------------|--|
| Problem 35 | <p>What is dad's basis to sue Maturin? 1) He is a Pee the note and 2) He is the maker of the note → Thus, he has makers liability Maturin claims to recoup the loss is a claim in recoupment. Maturin can assert a claim for it, so dad might only be able to demand \$700 (for dredging it up).</p> <p>Can Maturin subtract another \$100 b/c Aubreys dog but him? No b/c it did not give rise to the instrument Unrelated claims may not be asserted drawing</p> |
| Problem 36 | <p>What is Fincance CC's claim against Rupp? Maker's liability What is Rupp's defense? Fraud in the inducement</p> |
| Problem 37 | <p style="text-align: center;">Minor, 17, Δ ← \$800 → Piano Music Co ← \$1,725 → Big National, π</p> |
| Problem 38 | <p style="text-align: center;">Employer → Harold, 17 → Byron Auto → Crusaders → Drawee Bank \$1,000 ← car</p> |

FREEDOM FROM CLAIM AND DEFENSES AND PROCEDURAL ISSUES

Approaches to the 5 Real Defenses

- **The Linguistic Approach:** Look to the § to see if it expressly states whether the act was void

- **The Policy Approach:** Look to the underlying policy

So on the exam...

- "Under the linguistic approach, the Ct's look to the § of that jurisdiction to determine whether it is void. Here, the statute would show that _____ is/isn't void, thus _____. Under the policy approach, the Ct would consider the jsd's policy to weigh the policy in light of the current law."

Requirements

- 1) You must prove that payment is made by a person obliged to pay the instrument
- 2) By a PEEI

Exception: You paid it to a former PEEI before you received notice

Any transferee is deemed to have notice.... But before...

| | |
|-------------------|--|
| | |
| Problem 34 | <p>A HDC <i>takes free</i> of all defenses, except real defenses. Here, it is a real defense that she filed for bankruptcy § 3-304</p> <p>Does Shadbolt have any other remedies against National Nank? Any time you transfer an instrument for consideration, you may be incurring some sort of liability—transfer of warranties is one of them. They are going to have a transfer of warranty claim. The transfer of warranty was breached, which means Elsie can defend on the basis of insolvency.</p> |
| Problem 40 | <p>Drawing</p> <p>Will Malvolio's payment to Orsin Finance give rise to a discharge of payment? First, look to § 3-601(a). If it doesn't explain... look to §3-602(a). Payment of an obligation discharges the obligation if 1) it is made by a party obligated to pay the instrument and 2) payment is made to a PEEI the instrument. Then §3-602(b) that if here was paid by a person <i>formerly</i> entitled to endorse the instrument & 2) he was entitled to pay → §3-601(b)</p> <p>Did Olivia have notice of the discharge? A transferee or any party that acquired rights in the instrument is deemed to have notice, § 3-601(d).</p> |
| Problem 41 | <p>Milton would be liable as the maker, but he can argue the signature was not authorized in order to avoid liability. A person is not liable on an instrument unless they signed the instrument (or agent signed) § 3-401. Signatures are presumed authorized. A party who claims a signature was unauthorized has the BOP to overcome the presumption, § 3-401. Thus, Milton has the BOP to show the signature was not his. Remember, even a HDC must establish its case-in-chief. (You can prevent the arguing of HDC by proving that the instrument was forged, and thus it wasn't authorized in the 1st place (<i>see</i> § 3-401 and § 3-403 to document it). This approach could have been used in <i>Hanson</i>.</p> |
| Problem 42 | <p>General Rule: An instrument that contains a condition precedent is not negotiable, but there is an exception for counter-signatures</p> <p>Exception: countersignatures § 3-106i.e. <i>The instrument is not valid until there is a countersignature</i></p> <p>Does forging the counter signature create a defense? Yes. This failure to authorize is an Art. III defense of the obligation of the issuer. A countersignature is simply there for identification → A forged countersignature is an ordinary K defense, not a real defense. § 3-305(a)(i) → If it is a personal defense, check to see if they're a HDC. Vegas Check Cashing could be a HDC b/c they did give value. More facts are needed. The issue might be whether they had notice. § 3-60?</p> <p>If payee issues an exception to maker, who denies liability, but their answer to the pleading says nothing about the signature → the signature is presumed valid, § 3-308. This presumption effectually establishes the authenticity of a signature, However, they must still offer some proof. They should plead a forged signature as an affirmative defense (not a general denial). This requires that they</p> <ol style="list-style-type: none"> 1) Must plead a specific denial 2) Even if denied, there's a presumption that the signature is authorized 3) They have the BOP 4) If proved, BOP shifts to maker <p><i>VA National Bank v. Hott</i></p> <p>Facts: A sham note was disguised as income. Herzog was not a HDC, so they're just dealing w/ a lack of consideration defense, which is an ordinary K defense.</p> <p>All claims against someone who's not a HDC are subject to any real defense. A party may deny that they are the maker of a note, which was drawn on a forged signature. Signatures are presumed valid. A party who claims that a signature was unauthorized must offer evidence to overcome this presumption. A Ct will look to the states parole evidence rule to establish whether a separate K agreement may be used to modify, supplement, or nullify [an obligation? evidence of defenses) (doesn't apply to a HDC).</p> |

Drawing

DEFENSES AGAINST A NON-HDC AND JUS TERTII

DEFENSES AGAINST A NON-HDC

General Rule: All claims against someone who's not a HDC are subject to any real defense.

JUS TERTI DOCTRINE (RIGHTS OF ANOTHER)

General Rule: In an action against a PEEI, the obligor may not assert the rights of a 3P

- Accommodation parties are permitted to defend their principals
- If obligor has notice →
 - 1) May assert claims of another if that person **joins the suit or**
 - 2) **Instrument lost or stolen** (can go against HDC)

| | |
|-------------------|---|
| Problem 43 | <p>1) Is Jane a HDC? §3-602 The promise to buy lunch is an add'l undertaking, which prevents the note from being negotiable. Thus, Jane is not a HDC. <i>See</i> § 3-117</p> <p>Assume instead that Jane received it as a HDC. If she goes to Covey to pay, may he use it as a defense? No. He executed the note & therefore has maker's liability. Covey may have the defense of rescission b/c he would want to present the note. Stonevall may have a claim for conversion</p> <p>Would Covey be able to</p> |
| Problem | |
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| Problem | |
| Problem | |

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| Problem 59 Jack notified the bank he was nearing bankruptcy so the bank discharged his debt for \$5,000 | <p>a) Does Shadbolt owe the bank? Probably not. An agreement to discharge a principal obligor will discharge a secondary obligor unless otherwise specified by K (that the secondary obligor is not discharged). This applies to any release, including an extension.</p> <p>What if the bank retained that right? Shadbolt might be entitled to some discharge if he shows it causes harm. Thus, he would be entitled to the extent of the harm</p> <p>Drawing</p> <p>b) Does an extension discharge the secondary obligor? Yes. <i>Same rule</i></p> <p>c) Assume instead that Jack put stock down as collateral. Upon request, the bank returns it but charges a higher rate of interest. The original note agreed that any surety agreed to impairment of the collateral =. Is Shadbolt discharged? No. §3-605 (h)</p> <p>d) How could they have avoided it? Include a waiver. Common.</p> |
| Problem 60 | <p>a) When they executed the 2nd note, it suspended the 1st note & they can't sue on it</p> <p>b) What remedy? They can attack the 1st note if they dishonored (refused to pay) the 2nd note</p> <p>c) 3-605 (c), § 3-304(b) When an instrument of a definite time is overdue EXCEPT if default on principal payment → May put you on notice of an issue (vs. non-payment of interest which isn't)</p> |
| Problem | |
| Problem | |
| Problem | |

THE CHECKING ACCOUNT RELATIONSHIP BETWEEN BANK AND CUSTOMER

“PROPERLY PAYABLE” RULE

Definition:

WRONGFUL DISHONOR

Definition:

DEATH OR INCOMPETENCE OF THE CUSTOMER

Definition:

THE BANK’S RIGHT OF SETOFF

Definition:

CUSTOMER’S RIGHT TO STOP PAYMENT

ORDINARY CHECKS

Definition:

BANK CHECKS

Definition:

BANK STATEMENTS

Definition:

| Problem | |
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| Problem | |

WRONGDOING AND ERROR

FORGED INDORSEMENTS: WARRANTY AND CONVERSION LIABILITY

Definition:

| FORGED INDORSEMENTS EXAM/BAR SUMMARY !!! | |
|---|---|
| Customer → Payee → Forger /s/Payee → Check Cashing Store → Depository Bank → Payor/Drawee Bank | <p>Scenario #1: Assume the Payor/Drawee Bank HONORS the check</p> <p>Because the signature was forged, and thus the item was not properly payable, 1) the drawee/payor bank must re-credit the customer's account. The drawee bank can recover for breach of presentment warranties, against the person obtaining payment and the prior transferors b/c none of the persons demanding payment are a PEEI and the signatures were unauthorized. The payee would have been the only PEEI. The payor bank has no ability to check for a forged indorsement, so the check store should be liable since it is in the best position to discover a forged indorsement (b/c it is most closely associated with the customer).</p> <p style="margin-left: 40px;">1) None of them are a PEEI & 2) The signatures are unauthorized</p> <p>Scenario #2: Assume the Payor/Drawee Bank DISHONORS the check</p> <p>The depository bank cannot sue the customer. 1) There's no drawee liability b/c they're not a PEEI. That duty is only owed to a PEEI. 2) b/c a) none of them are a PEEI and b) the signatures are not authorized. 3) Since the payor bank dishonored the check, the depository bank can sue from prior transferors for breach of transfer warranties b/c none of them were a PEEI and the signatures were not authorized. The loss is sent back down the chain of title.</p> |
| Forger → Forger /s/customer (b/c forger is picking up a check and forging it) → Check Cashing → Depository bank → Payor/Drawee Bank | <p>Scenario #1: Payor HONORS the check</p> <p>1) Since the indorsement was forged, the payor/drawee bank must re-credit the customers account because the item was not properly payable. 2) The payor bank cannot succeed on a claim for breach of presentment warranties but will most likely fail because a) they are a PEEEEI and b) the draft has not been altered and c) the only person with actual knowledge that the signature was unauthorized is the forger. 3) The drawee might recover. The only other remedy that would be allowed is if the drawee pays under the mistaken belief that the signature was authorized by a person for who's benefit it was made. In that case, it can recover against the check cashing store. However, this is subject to (c): that it can't recover against a person that took ? payment was made in good faith and for value. 4) Thus the loss from the forgery will almost always be drawn by the drawee.</p> <p>Scenario #2 Payor DISHONORS the check</p> <p>1) There is no drawers liability b/c th drawer never signed the check. A forged indorser in the capacity for which he signs. Thus when a forged indorser signs, the signature is treated as their own. Thus, the customer is not liable. 2) The depository bank can bring a transfer warranty claim against anyone, which would claim that all the signature are authentic and authorized (by the forger?) The result is that it's sent back down the chain of title. They can't go after the holder (i.e. the forger) b/c there's nothing wrong. ?</p> |

FORGED CHECKS: FORGERY OF THE DRAWER'S SIGNATURE

Definition:

VALIDATION OF THE FORGERY

COMMON LAW VALIDATION

Definition:

THE IMPOSTOR, FICTITIOUS PAYEE, AND PADDED PAYROLL RULES

Definition:

THE EMPLOYEE INDORSEMENT RULE

Definition:

THE NEGLIGENCE RULE

Definition:

THE BANK STATEMENT RULE

Definition:

ALTERATIONS

Definition:

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| Problem | |

CHECK COLLECTION PROCESS

FUNDS AVAILABILITY

Definition:

CHECK TRUNCATION

Definition:

FINAL PAYMENT

Rule: Once final payment has occurred, dishonor is no longer possible. Therefore, there is no longer drawers liability or indorsers liability

§ 4-302

- Triggers banks liability

A bank can be completely liable for the In if it chooses to do a split deposit, even if there were not sufficient funds to pay the check

- i.e. ½ cash, ½ deposit

When Final Payment Occurs

- In cash
- ...settlement
- When payor bank misses its deadline

Effect of Final Payment Occurring: Payor bank is accountable for the item and usually has no way to avoid payment
Payor bank must send notice to dep bank by the second bus day on the 2nd banking day. If the payor bank fails to provide this notice, it is liable for actual DAS up to the amount of the item

Settle: to pay in cash by clearing-house settlement, in a charge or credit or by remittance, or otherwise as agreed. A settlement may be either provisional or final

- When payor bank settles an item and the bank has no right to revoke it
- This def. only applies when **no right to revoke exists**
- If a right to revoke the settlement exists → this def doesn't apply

A settlement w/out the right to revoke will almost always occur when there's a tellers check or a bank check **§ 4-215 Cmt 8**

Where a bank holds onto a check past its midnight deadline, final payment will occur

§ 4-302(a)(1)

- To avoid this, the bank must pay or dishonor the check
- Most checks come to the payor bank from another bank
- If the payor bank holds onto the check past this special deadline, then final payment has occurred
- When payor bank receives a check, it has until midnight the following banking day to pay that item. If it doesn't, final payment occurs.
- **Midnight Deadline:** Midnight on it's *next* banking day
- **Regulation CC permits banks to miss their midnight deadline in 2 situations**
 - Payor bank can return the item before midnight **or**
 - Uses a highly expeditious means of transportation, even if this transportation wouldn't deliver the item until the next banking day

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| Problem 97 | What happens under 3-310(a), where you have a primary and/or a secondary obligation? Payment of an obligation by means of a bank check discharges the amount of the obligation up to the amount of the check What type of liability did Sally incur? Indorsers liability. Because the bank failed and the check has been dishonored, she is liable b/c under 3-310 discharge does not affect the indorser |

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| Problem 98 | § 4-108 validates the 2pm cutoff time. The check is deemed to be received on Tues, and it is due on the next banking day, which would be Wed at midnight. |
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When a payor bank is going to dishonor a check <2,500, Reg cc requires the payor bank to provide notice to the depository bank.

- **Reason:** Depository banks take the biggest risks unless they are alerted of dishonor

It must include complete information on the check, including:

- Payor bank - Acct number of depositor
- Routing number - Branch
- Depository bank - etc

If it fails to give notice → it is liable for DAS up to the amount of the item

Notice must be received by the depository bank by 4pm on the 2nd banking day.

Notice can be transmitted by any way that's possible. (banks usually use automatic email)

CHECK RETURN

CHARGE-BACK

Provisional Settlement

- When a check is presented, A bank may issue a *provisional settlement*, which credits your account
- But if the depository bank dishonors the check then the payor bank can charge back your account. (The payor bank retains a right of charge-back.) Your banks right to charge-back is not affected by failure to exercise ordinary care. The bank remains liable for DAS for failure to exercise ordinary care, only if it results in a loss.

Status of Collecting Bank....

§ 4-201(a)

Prior to final payment, a depository bank or any other collecting bank that learns payment on the check will not be made, may charge back a credit given to a customers for that check.

Right of Charge-Back or Refund; Liability of Collecting Bank

§ 4-214(a)

In order not to be liable for any losses resulting from failure to receive settlement, the depository bank must either 1) return the item or 2) give them notice why AND it must do so by it's *midnight deadline or any reasonable time* after it learns the facts

If this return or notice is delayed, the bank can still charge back, but the bank may still be liable for any loss resulting from the delay

When: In regards to *on-us* items, final payment takes place at the end of the 2nd banking day following receipt of the item

The EFAA rules only say when a customer gets to draw on the funds.

Valley Bank of Ronan v. Hughes, 246

- 1) Charge-back is always available to a depository bank unless final payment occurs & even if fails to exercise ordinary care
- 2) However, a customer may have a claim for DAS against the bank if it 1) _____ or 2) otherwise fails to do something

BOP: Customer (high burden)

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| Problem 100 | In regards to <i>on-us</i> items, final payment takes place at the end of the 2 nd banking day following receipt of the item |
| Problem | The EFAA rules only say when a customer gets to draw on the funds. If the funds are there and they don't get the |

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| 101 | cashiers check, then too bad. Here he complied with the rules, but the EFAA doesn't say anything about a customers right to keep those funds, so the bank was still able to charge back the provisional credit. The most prudent thing he could have done before giving away the motorcycle, would have been to call the bank and see if the funds were there. |
|------------|--|

UNDOING FINAL PAYMENT

Remember: When final payment occurs, the payor bank must pay the item and can't recover **except** in the following circs:

- Bad presenter: CL restitution made for payment by mistake or fraud will allow them to undo final payment where...
- Presentment warran still survive (but most times no warranty has been breached so usually left w/ CL restitution claim)

...becomes liable. By becoming liable they lose the right to dishonor (indorsers off the hook)

If the drawer or maker against the payee or any other holder...

§ 4-407(3)

§ 3-418

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| Problem 103 | Whoever presents payment to the payor bank makes 4 warranties: 1) they're a PEE 2) no alteration 3) authorized and 4) ...see earlier notes. They have a defense b/c they can claim the person seeking enforcement was seeking collection knowing the check wouldn't be paid. They're also given an affirmative claim under 3-418(b) to recover from the person for whose benefit payment was made. |
|--------------------|--|

DELAYS

Delay by a collecting or payor bank beyond the time limits prescribed may be excused if **§ 4-109(b)**

- 1) Circs beyond the banks control that cause delay & **!!!** i.e. interruption, mistake, emergency, *NO control, etc.*
- 2) Bank must exercise reasonable diligence as the circs could require

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| Problem 105 A janitor shreds a check accidentally. What result? | There's no doubt that final payment is going to occur and the bank will miss their deadline. Under § 4-109(b) delay beyond the time limits may be excused if 1) circs beyond the bank that cause delay & 2) Bank must exercise reasonable diligence as the circs could require. Those are the 2 things the bank must prove. |
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RESTRICTIVE INDORSEMENTS

2 Ways

- 1) An indorsement that signifies a deposit or collection *only* *i.e. for deposit*
- 2) That payment is to be made to another person or other fiduciary for the benefit of indorser

A depository bank is liable for conversion **vs.**

A payor bank or an intermediary bank may disregard the indorsement & isn't liable if proceeds weren't received, **3-206(c)(4)**

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| Problem 106 State → Needy for deposit only /s/ Needy → Runner /s/runner → Pursesnatchers Bank /s/ Runner → Innocent Bank /s/ Innocent → Welfare Bank | The only one she can sue is Pursesnatcher Bank b/c 3-206(c)(2) AND A payor bank (Welfare) or Intermediary Bank (Innocent) may disregard the indorsement & isn't liable if the proceeds weren't received 3-206(c)(4) |
|--|---|

PRIORITIES IN THE BANK ACCOUNT: THE “FOUR LEGALS”

Issue: What gets paid first

Accountable – Liable for the amount of the item

Once [certification of a check **or** final payment of the check] occurs, none of the following can stop final payment of the item:

- Notice of...
- Banks right of setoff
- Service of Legal Process
- Stop payment order from a drawer

EX: Thurs morning a payor bank certifies a check for x.

- If the writ arrives *after certification* →
- If the writ arrived *prior to certification* → bank would have had priority and the garnishment order could occur

Bank has complete discretion to pay checks in any order, at their discretion

§ 4-303(b)

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| <p>Problem 107 On 10/5: balance=4K On 10/6 (morning)</p> <ul style="list-style-type: none"> • 1k paid • 500 paid • 3k <p>On 10/6 (noon)</p> <ul style="list-style-type: none"> • Requests Hold <p>On 10/6 (1pm)</p> <ul style="list-style-type: none"> • 500 <p>On 10/6 (2pm)</p> <ul style="list-style-type: none"> • TR notifies bank he’s declaring bankruptcy <p>On 10/10</p> <ul style="list-style-type: none"> • \$75 • 3K return | <p>Can the trustee claim the bankruptcy filed on 10/5 froze the account as to the \$4,000? No. The bank isn’t liable until it receives notice (at 2pm). The notice was given on 10/6 at 2pm, which was after the payment of the 4th check for \$500. That trumps the trustees claim.</p> <p>What about the \$75? The bank must turn it over to the trustee b/c the payment occurred after the bank received notice of the bankruptcy</p> <p>What about the \$3,000 on 10/10? The bank is liable for the \$3,000 b/c it didn’t return it by their midnight deadline. The banks only remedy would be to file a claim as a creditor w/ a <i>pro rata</i> right of restitution</p> |
| <p>Problem 108 There’s 5K in an account when a bundle of checks arrives</p> | <p>What order must they be paid? The bank can pay them in any order that it likes.</p> |

ELECTRONIC PAYMENT SYSTEMS

Probably will change:

Won't change: Negotiability of Instruments & Promissory notes

CONSUMER TRANSACTIONS: CREDIT AND DEBIT CARDS

Federal Truth and Lending Act (TILA) was amended in 70's to provide for credit cards

Regulation Z

- Supplements TILA
- Unlike debit cards, credit cards can't be issued w/out the consent of the consumer
- Consumer must accept by signing or using it (before they can be liable) !!! e.g. throw away, never liable
- \$50 max liability for unauthorized use of a credit card !!!

If a consumer voluntarily allows someone else to use their...

- ...**credit card**, the consumer will be liable for the entire amount, even if it exceeds the amount of their agreement !!!
- ...**debit card**, the max liability will be the amount authorized

Apparent Authority

- Principal leads their agent to believe another person has authority, but it was never granted. *Azur v. Chase Bank, 337*
- aka "cloaking the agent with power"
- i.e. credit card issuer led to believe their authority was authorized

Defenses Against Card Issuer

The difference b/w CC and debit cards!

- **Applies:** Something wrong w/ card
- **Reg Z allows consumer to complain about difficulties w/ card**
 - If consumer tried to settle a problem w/ a merchant (to honor the card) & !!!
 - Amount involved must exceed \$50 & !!!
 - Occurred w/in consumer's home state or w/in 100 miles !!!
- But card issuers usually honor consumer's request & let merchant/consumer fight it out
- **Exception:** Not req'd to meet them if bought from catalog from the card issuer

Reporting Credit Card Errors

Regulation Z

- **Consumer** must complain of the error, in writing, w/in 60 days !!!
- **Card issuer** has **30 days** to resolve, during which time it **may not report the charge as delinquent to credit agencies !!!**
- If card issuer doesn't comply w/ Reg Z faces DAS

Electronic Funds Transfer Act (EFTA) & Reg. E

- **Purpose:** Governs any transaction in which a consumer uses e-means to access bank account !!!
- **Applies:** Electronic funds transfer i.e. debit card, ATM
- **Doesn't Apply:** Business use
- **Electronic Funds Transfer:** Transfer of funds, not initiated by paper instruction, but initiated thru an e-terminal phone or computer that authorizes a consumer to debit a bank acct

Before granting auto-payments, banks must notify the consumer of:

- What they could be liable for
- Phone # and address to report unauthorized transfers
- # of business days it must be reported w/in
- Stop-payment procedures

Banks can...

- ...mail out unsolicited debit cards a.l.a. the card is validated (consumer must take a step) i.e. call
- ...send out statements that reports both checks and EFT

Bank must...

- ...tell consumer each time a preauthorized transfer was scheduled to occur & if it did or did not occur

Consumer Complaint Requirements I Resolving Errors

- Consumer must...

- ...provide [oral or written] notice of errors w/in 60 days of statement to their financial institution/bank !!!
- ...provide all info in their possession about the error, reason for error, etc

- Bank must...

- ...promptly investigate the alleged error & give findings
 - 10 days to investigate
 - can be extended by 45 calendar days ala it recredits the acct at the end of the 10 days that the investigation period expires !!!
- ... give customer 5 days warning before un-crediting acct

Unauthorized E-Funds Transfer

- Definition:

- Any EFT from customers acct not authorized by the consumer &
- Consumer receives no benefit

- Doesn't Include: Transfer by financial institution that causes the problem...*but consumer is protected b/c they have NO liability*

- Consumer can give the institution notice that power for charges is revoked

Consumers Liability

- **Gen Rule:** Consumer is liable for only \$50 !!!

- Exceptions

- 1) Failure to report card missing w/in 2 business days → consumer may be liable for any unauthorized trn, up to \$500 !!!
- 2) Failure to report bank statement problems w/in 60 days → customer may be liable for unlimited liability !!!

- If a consumer authorizes a trn that the bank doesn't process, the consumers obligation is suspended unless written notice is provided to the consumer from the obligor when they have an electronic fund transfer agreement in place

| Problems | Answer |
|--|--|
| <p>Problem 146 The answer is one of these rules</p> | <p>Regulation Z</p> <ul style="list-style-type: none"> - Unlike debit cards, credit cards can't be issued w/out the consent of the consumer - Consumer must accept by signing or using it (before they can be liable) !!! e.g. throw away, never liable <p>Rule: If a consumer voluntarily allows someone else to use their...</p> <ul style="list-style-type: none"> - ...credit card, the consumer will be liable for the entire amount, even if it exceeds the amount of their agreement !!! - ...debit card, the max liability will be the amount authorized |
| <p>Problem 147 Linda refused to pay her CC bill b/c: 1) Her only option was to stay at a hotel outside the state, <100 miles</p> | <p>What result under Regulation Z if Linda complains & doesn't want to pay her CC bill for...</p> <p>...the hotel? Linda may be responsible for the bill b/c it was located outside her state and < 100 miles from her residence</p> <p>...the suitcase? She can probably recover</p> |

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| <p>away, which was distant and double the price</p> <p>2) A new suitcase she purchased fell apart</p> <p>3) Artwork she purchased for \$25 from a local merchant never arrived.</p> <p>4)</p> | <p>...the artwork? Generally a consumers purchase must be over \$50 for them to have a valid defense against payment. Since the artwork was only \$25 she would normally be unable to recover under the general rule. However, Linda may be able to recover the charges b/c it was advertised in a catalog from the card issuer.</p> |
| <p>Problem 148</p> | <p>(a) Can EE refuse if EM demands auto-deposits? No. a.l.a. EE cant refuse a.l.a. they can select where the funds are deposited. <i>Describe auto-deposit disclosure req'ts</i></p> <p>(b) Can't be sued or evicted on an underlying obligation, provided an agreement is in place, until the obligor provides written demand</p> <p>(c) Is oral notice sufficient? Yes timely? Yes if bank fails to stop pymt does she have a remedy? Yes DAS? Actual DAS (any DAS prox caused)</p> <p>Assume she had DAS if she had a legit dispute w/ landlord & rent paid 2x: Bank could assert a subrogation claim. Bank allowed to step into the shoes of the customer & assert claim against landlord</p> <p>If Linda made a point of sale EFT (over the counter) No b/c it was authorized</p> |
| <p>Problem 149</p> | <p>EFT doesn't apply b/c not primarily for personal, family or household furniture</p> |
| <p>Problem 150</p> | <p>Should the end of the month bank statement reflect this transaction? At the time of the transfer, if the consumer wants a receipt, it must give one. § 4-406, § 906(a) & (c); 1693(d).</p> <p>What must be in it? Amount involved, date of transfer, type of transfer, transfer amount, identity of consumers account, identity of any 3P to whom funds are transferred, and ID and location of the e-terminal involved, § 906 <i>See</i> page 1459 (in consumer credit protection act)</p> <p>Discrepancy under 906(c), Periodic statement required See (1)-(4) for what must be provided Under §4-406 (f) normally the customer must notify the bank w/in 1 year of a statement of an unauthorized transaction. However, cash is not considered an item under Art. IV so §4-406(f) doesn't apply.</p> <p>But, under the EFTA, there is a 60-day period. He has 1 year to bring his action, which has passed, § 916(g) or § 1693(m)(g).</p> <p>He must give the bank oral or written notice w/in 60 days after the bank sent him the bank statement.</p> <p>The bank has 10 business days to investigate the error. It can extend this an add'l 35 days if it re-credits the customers account.</p> <p>Can it be provided at same time as statement? Yes If he fails to examine statement for over 1 year, any problems from EFT Act? § 4-406(f) customer has 1 year period to notify bank of problems. In this case, just dealing with ATM transaction.</p> <p>Is 4-406 even applicable? No, it deals with an ITEM. Cash is not an item for purposes of Art 4 so that rule is not applicable. But the bank can use EFTA Act-60 day period of repose. 1 year SOL *** see 916(g) – pg 1468</p> <p>If he sees it on statement and discovers error, needs to give oral or written notice w/in 60 days from</p> |

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|---|---|
| | <p>time bank sends statement. Bank has 10 days to investigate w/o having to recredit If it wants more, can have add'l 30 days but must recredit acct w/in 10 day period</p> <p>Who bears the burden of proof? The bank Why? ATM should have given documentary evidence of the transaction</p> <p>Bank liable for actual DAS caused. Includes if check bounced and he had fees associated, had to hire attorney, etc.</p> |
| <p>Problem 151 He threw the pin letter in the garbage</p> | <p>If the card came to him ready to go then the financial institution has violated the EFTA. No liability attaches for him b/c he has not accepted it.</p> |
| <p>Problem 152 4/30 500 450 5/5 800 50 → 500 5/31 Hartemont 6/10 3000 7/31</p> | <p>His max liability is \$500</p> |
| <p>Problem 153 Can writing your pin on your card increase your negligence liability?</p> | <p>Customers negligence does not alter the EFTA. However, the bank may have addressed it in the K w/ the customer</p> |
| <p>Problem 154</p> | <p>Not on exam</p> |

PRACTICE PROBLEMS

PROBLEM 1

Maker executed and delivered to Jake a negotiable promissory note payable to the order of Jake. Jake negotiated the note by blank indorsement to Jon, who negotiated the note by special indorsement to Michelle, who negotiated the note by special indorsement to Dave, a holder. Dave demanded payment from Maker on the due date, but maker refused to pay. Two weeks later, Dave informed Jon of the dishonor by telephone. Dave never gave notice of dishonor to Jake or Michelle because he did not know how to contact them. Two months have passed since the note was dishonored. Jon is:

- a. Not liable to Dave on his indorsement because Dave's notice of dishonor was not in writing.
- b. Not liable to Dave on his indorsement because Dave's notice was not timely.
- c. Liable on his indorsement, but only to Michelle (the person to whom Jon negotiated the note).
- d. Liable to Dave on his indorsement**

D is correct b/c § 3-414 imposes liability on John when the maker dishonors the instrument. It is owed to a PEE. Dave is a holder. Under 3-301(1) the PEE rule comes up: that a holder can be a PEE, per 3-301(i). John received notice of dishonor, which was timely b/c it was given w/in 30 days of the day of dishonor, per §3-505(c) Oral notice of a dishonor is ok. !!!

C is incorrect b/c Johns liability as indorser doesn't stop at the person who negotiated the instrument.

PROBLEM 2

2. Assume Jon and Michelle are business acquaintances, and Jon gave written notice of dishonor to Michelle two days after Dave telephoned Jon. Michelle is:

- a. Liable to Dave on her indorsement.**
- b. Not liable to Dave on her indorsement because Michelle received notice of dishonor from Jon, not Dave.
- c. Liable to Jon on her indorsement if Dave collects payment from Jon.
- d. Not liable on her indorsement if it was accompanied by the phrase "without warranty."

A is correct b/c the note has been dishonored and Michelle received timely notice of dishonor, specifically, within a reasonable amount of time which 30 days meets. Thus, she is liable b/c she was given notice of dishonor w/in 30.

C is incorrect b/c per the last sentence of § 3-415(a), an indorsers liability is owed to a subsequent indorser (not a previous indorser).

D is incorrect b/c an indorsement accompanied by the phrase " ___ " is effective. But here it says "w/out warranty," which only applies to presentment warranties (???)

PROBLEM 3

Hailey owed Connor \$1,000. She placed her personal \$1,000 check (payable to the order of Connor) in a stamped envelope, which she put in her mailbox at the end of her driveway. Brady noticed the mailbox flag in the "up" position, opened the mailbox, and took the envelope addressed to Connor. Brady then forged Connor's special indorsement ("Pay to Brady/Connor"), drove to First Bank, and deposited the check into his account. First Bank timely presented the check to Second Bank, which timely honored the check. Which statement is true?

- a. First Bank breached the transfer warranty regarding its status as a person entitled to enforce the check.
- b. Connor has a claim against Second Bank for statutory conversion.
- c. Second Bank is liable for statutory conversion.
- d. Brady breached the presentment warranty regarding his status as a person entitled to enforce the check.**

D is correct. Presentment warranties are made by any person obtaining payment or any previous transferor. Brady transferred the check at the time of deposit. Brady was not a holder b/c the check was payable to Connor. So Brady can't claim enforcement rights as a holder. Brady also doesn't get it under the shelter rule b/c he's not a PEE.

A is incorrect b/c First Bank *presented* the check to Second Bank for purposes of payment. Absent any transfer, a person makes no transfer warranties.

B is incorrect b/c delivery never occurred under 3-420(a) an action for conversion of an I can't be taken if the person claiming it has not received delivery. He retains a claim on the underlying obligation

Hailey has a claim against the bank to have her account re-credited b/c the check was not properly payable. She doesn't need to make a conversion claim.

PROBLEM 4

4. Olivia agreed to purchase Traci's car for \$15,000. Traci agreed to take a \$15,000 check from Olivia. Traci comes to you for advice on whether to take Olivia's personal check, or a cashier's check issued by Olivia's bank, and whether the difference will affect Traci's ability to sue Olivia on the underlying contract. Provide a response.

Start w/ § 3-310, which addresses what happens to an obligation in a cashier's vs a reg check. Under § 3-310(a) the underlying obligation is going to be discharged b/c the bank is going to substitute its final payment obligation for the (b/c paying cash).

A party who takes this special check is expected to cease pursuing the underlying obligor. But under §3-310(b) the result is different. If the K'ing party pays w/ a personal check, the underlying obligation is *not(???)* discharged. Instead the K obligation is suspended in the amount of the check until its dishonored or paid. If the check is dishonored, the suspension is lifted and, as a general rule, the person can sue on both the underlying obligation and the check. If the check is certified, the is discharged.

FINAL EXAM REVIEW

*This review covers big picture issues.
There will be little nuisances on the exam that aren't covered here*

Big, Big Picture: Payment Systems in a Nutshell

- Negotiability
 - Does it meet the formal requirements?
 - If it doesn't, doesn't mean instrument is dead, just means Art 3 & 4 don't apply... still have contract law
 - All this means is that holder has no greater rights than assignor. Whoever transferred it receives those rights
 - Art 3
 - Art 4
 - If instrument is negotiable, ask *has there been a transfer as to constitute a valid negotiation*
 - Negotiation is diff than negotiability
- What liability attached to instrument?
- When determining liability, ask: *What defenses are there?*
 - If they are a HDC, it is subject to the five real defenses.
 - If they are not a HDC, they can use the common-law defenses

Negotiable Instruments

If an instrument is NOT negotiable, Art III and Article IV won't apply. However, the law of contracts may apply. This means the holder will have no greater rights than an assignor. But under Art III someone ... can be a HDC

If an instrument IS negotiable...

After determining that it's a negotiable instrument that has been transferred → and thus, that liability has been incurred → there is maker's liability and drawer's liability. You could also have conversion, negligence, you could be an accommodation party & have liability on the instrument

- If an instrument goes to a HDC → it will be subject to certain real defenses
- If an instrument goes to another party that's not a HDC → it will be subject to CL defenses (lack of consideration, etc)

Types of Commercial Paper

- A **note** is an instrument b/w a maker and a payee (2 parties), containing a written promise to pay money to a designated party by maker.
- A **note of the bank** is a certificate of deposit (CD).

- A **draft** is an instrument b/w a drawer, a drawee, and a payee (3 parties) that is an order to pay money. The drawer of the draft must order the drawee to pay the instrument. The drawee is usually a bank.
 - *Remember, a check and a cashier's check are different:*
 - It is a **check** if the draft names a bank as a drawee.
 - It is a **cashier's** check if the drawer and the drawee are the same. A cashier's check is drawn on the bank itself.
 - *Big Picture:* The law protects a HDC who is in possession of a note.
 - **Several exam questions may arise as to whether or not the HDC defenses apply**

Defining instruments

- A **negotiable promissory note** is a negotiable instrument.

The requirements of negotiable instruments are on the exam.

Example Exam Question: Discuss whether this clause would kill negotiable instrument under Art 3.'

Example Exam Question: You have this sort of promise contained, is that too much to make it negotiable?

Is it a Negotiable Instrument?

A negotiable instrument must 1) be in writing, 2) signed by a maker or a drawer who has present intent to authenticate, 3) that contains an unconditional promise or order 4) to pay a fixed amount of money, 5) that is payable on demand or at a definite time, 6) must contain to bearer or to order, 7) that requires no other undertaking or instruction.

There will be multiple choice questions where you must determine whether it is a NI, as well as on whether certain things will kill negotiability.

- **In writing.** A negotiable instrument cannot be made orally.
- **The Signature**
 - The person making the signature must have a present intent to authenticate.
 - A person may authorize an agent to sign an instrument. Thus, a signature is valid if you sign it as a DBA.
 - A persons whose name is signed under a forgery or whose signature is otherwise unauthorized → is not liable on the instrument unless they have ratified the instrument, in which case they may incur liability. A forger who signed the instrument is liable in the capacity for which he signed.
- **Burdens of Establishing Signatures**
 - Unless specifically denied in the pleadings, each signature on the instrument is deemed to be admitted. This is an affirmative defense.
 - Assume the defendant raises an issue in his pleadings as to the authenticity of the signature. The burden is on the plaintiff. The presumption is that all signatures are authorized so the burden of proof is on the defendant.
- **Unconditional Promise or order to pay**
 - **Express conditions** always destroy negotiability.
 - Statements that a note is **subject to** something destroy negotiability.
 - **Rights stated in another writing** destroy negotiability.
 - i.e. see Security Agreement
 - A reference does not destroy negotiability.
 - i.e. this note is executed in accordance with x settlement agreement OK
 - Prepayment penalties before default are governed by the settlement agreement and do not destroy negotiability because it benefits the holder.
 - Statements of security or collateral do not destroy negotiability. They are usually described in a security agreement.
- **Fixed Amount of \$.** Money is a medium of exchange that is offered for currency.
 - **Notes.** A note is a simple “pay to the order of xxx.” All a note must show is there’s a fixed amount of money
 - A note is valid even if it is written out in foreign currency. It can be made payable in U.S. dollars, unless it otherwise states that it is only payable in foreign currency.
 - An interest rate doesn’t have to be stated on a note. If the note is silent (doesn’t contain an interest rate, the instrument will be deemed to accrue no interest. If interest is mentioned but the rate is not included, the judgment rate (???) will be used.
 - Unless it (???) can be determined from the face of the instrument → the instrument is not negotiable
 - An instrument payable on sight or on presentment is a **demand instrument**. A demand instrument means the holder can present the instrument whenever he or she desires.
 - *Remember, an instrument is payable at a definite time if its payable at a fixed date. It may be payable on or before a fixed date.*
 - An **acceleration clause** is ok to have in the instrument. An acceleration clause makes the instrument payable earlier than the original date.

- An **extension clause** makes an instrument payable at a date later than the maturity date. An extension clause is valid as long as (...) is still able to be calculated.
 - An **extension at the option of the maker or drawer** means the maker retains the option to extend the time payment is due as long as it states a definite time as to when payment is due. The extension is only valid if a new maturity date is stated in the instrument. A maker cannot be given the power to extend the date of payment without including a specified date in the note
 -
 - An **extension at the option of the holder** is valid if the instrument is payable at a definite time. The holder has the right to extend the date of payment to any definite time.
- **Words of Negotiability**
 - An instrument that is **payable to bearer** only requires delivery. It means there's no specific payee.
 - It might say *pay to bearer*
 - It must designate a specific payee. *i.e. Payable to merry x-mas → not ok*
 - An instrument that is **payable to order** requires both 1) payment (indorsement) and 2) delivery.
 - *Remember, if an instrument is not made payable to order or bearer it is not going to be negotiable* The one exception is a check, which you can write "pay today"
 - A negotiable instrument can not state an undertaking or instruction to do any act other than paying the money, but there are **exceptions**:
 - A **confession to judgment upon default** is allowed by the code.
 - A promise to pay followed by a **promise to maintain collateral** is allowed by the code.
 - A **waiver of the benefit of a certain loss** is allowed by the code. *i.e. we waive the right to presentment. We waive the right to notice of dishonor.*

How we negotiate

- **The important issue** is whether we are dealing with bearer or order payment.
- **Negotiation** is a process where an instrument is transferred making them the holder. That's diff than the initial issue of negotiability and ... different if it is the drawer or the holder
- **Delivery.**
 - Bearer paper only requires delivery.
 - Order paper there must be indorsement and delivery
- A payee's indorsement must be valid.
- A person is not a **PEEI** unless the **...instrument...** has been authorized & is valid.
- **What if it says Dave and Michelle are payees?** They both must sign otherwise it violates the properly payable rule.
- **What's the effect of transferring a check that's pay to the order of...?** The **...** is still going to be effective to transfer the instrument. but then there's the **shelter rule**: a person may be sheltered as to a HDC—they're not a holder until they get that indorsement, but they can be a PEE because **...** if they paid value they can go back to **the depository bank?...**
 - If an indorsement is later obtained, that person, upon obtaining it, becomes a holder and they also become a PEEI. *Recall, that to be a HDC you must be a holder.*
 - If you failed to convey holder status because you failed to endorse it → the person who receives the instrument is a holder.
 - **For banks.** A depository bank that takes an un-indorsed check is conferred holder status as long as you were a holder.
- **Ways to indorse an instrument**

- A **special indorsement** is where you indicate a new payee on it. *i.e. pay to the order of Dave, signed Dave indorsed as pay to the order of Kristi.*
- If you just sign "Dave" its bearer paper.
- If you sign "pay to the order of Dave" it is order paper
- Notice that it can be changed from bearer to order paper very quickly.
- You can sign in blank.
- You can sign "without recourse".
- You can sign **restrictive indorsements** *i.e., for deposit only*
- A person who signs an instrument with an **anomalous purpose** will also become an accommodation party. An **anomalous indorsement** occurs when a maker signs the bottom of the instrument & (takes on liability as a secondary party???).... It means taking it on as an accommodation party. It is a weird thing to do.

=====REVIEW PT II=====

HDC

- A **holder in due course (HDC)** is a 1) holder 2) who takes an instrument for value 3) in good faith 4) and w/o notice.
- **Without notice** means that they do not have knowledge, nor should they reasonably have been expected to have knowledge, that the instrument is overdue or has been dishonored, that there's an uncured default, that it has an unauthorized signature or was altered, w/o notice of any claim to the instrument (*see* § 3-306 HDC Claim) & w/o notice that any party has a defense of a claim in recoupment.
- It is only necessary to prove HDC status only when the holder has a defense to the instrument. A holder can enforce the instrument and has the right to sue. **On the exam, don't worry about HDC unless someone is bringing a defense to payment.**
- Some states don't like HDC rules and have instead enacted regulation statutes regarding how HDC status works. *i.e.* A Federal Statute that is placed in these notes that doesn't kill negotiability. They must have notice and ... can't be waived. This is supported by the UCC.
- When a party has a defense, you must consider whether it is a real defense or a personal defense.
- Also consider the difference b/w a claim (an affirmative COA) vs. a defense (a ground for refusing to pay).
- *Remember*, if we have HDC → we are dealing with the real defenses, e.g. incapacity, fraud in the factum, discharge, bankruptcy, and illegality. Only the real defenses work.
- **Real Defenses**
 - *Can be held liable regardless of if HDC attacks*
 - **Infancy** is only a real defense in a K action. If infancy doesn't make a K void/voidable then **capacity** is a real defense if they lack the capacity to K & it is void. Look to state law to determine the age of capacity.
 - **Illegality** is a real defense if some illegality in the underlying transaction makes it void. *i.e.* The type of transaction in state X is illegal. The statute will indicate whether it is void or voidable. It might be a real defense if the statute says it is void.
 - **Fraud in the Factum** is "real fraud." *i.e.* You slip in a promissory note when Michael Jordan is signing autographs.
 - Type 1 is **Fraud in the Factum** requires that the person have 1) neither knowledge nor 2) a reasonable opportunity to know of the terms nor a reasonable opportunity to learn of it. For example, if a farmer is alone in his field when he is given documents to sign. *Ask:* Did the farmer have a reasonable opportunity to ascertain that it was a promissory note? Yes, he had a reasonable opportunity to ascertain the terms.
 - Type II is **Fraud in the Inducement**
 - Most fraud is a real defense
 - **Discharge in bankruptcy**

Liability on a note that gets transferred to someone else

- What happens if you keep making payments for a note to the holder? The obligor on an instrument may continue to pay the original payee until the obligor is notified that the instrument has been transferred to another. *i.e.*, an obligor is still on the hook if he is on notice but continues to make payments to the holder (the original party).

How an alteration might still be a defense (vs. an unauthorized completion)

- In an **alteration**, the definition changes in terms of an instrument 1,000-10,000. A HDC may only be able to collect the original amount. The *policy* is that an obligor shouldn't have to pay on an instrument for which they never agreed to.
- In an **unauthorized completion**, which is filling in the blanks left by a maker or the drawer, the maker will not be liable for the full amount, but he will be for the unauthorized completion.

Forgery kind of serves like a real defense. If the name of the payee is unauthorized, then they are not a holder and thus, they are not a HDC.

- **Forgery of the maker/or drawers signature**

- Subsequent takers might qualify as a HDC if they meet the HDC test. This is b/c no person is liable on an instrument unless they signed the instrument. There is no liability from outset if they never signed.

PERSONAL DEFENSES

- **HDC gets to give you the middle finger vs the other way around**

- They are many defenses or claim other than the real defenses, such as, the defenses of recoupment, misrepresentation, breach of K, breach of warranty, lack of consideration, and more. Use these defenses when dealing with a HDC claim. If you win → they are not a HDC.

The **Just Terti Doctrine** states that an obligor cannot assert the claims of a 3P, unless they are an authorized agent of the principal.

Liability of Parties. Must identify status of each party. Are they a maker, an accommodation party, an indorser, etc?

Even when a HDC isn't involved suits on the instrument happen:

- **Suits on the underlying obligation: Merger**

- A negotiable instrument is usually issued for some reason. It [???] is not available as a COA.
- When a **regular check or a note** is given for an obligation → can't be offered for payment b/c the obligation was suspended. e.g. when a tenant gives payment to their landlord, the tenant's obligation is suspended.
- A holder may sue on the instrument, the underlying obligation, or both...until it is dishonored, paid, or both e.g. a holder could sue on the lease b/c the lease is the instrument.
- If a **cashiers check is given for an obligation**, the obligation is discharged as soon as they receive the cashiers check.

Liability of Makers

- **Anyone** signing an instrument undertakes to pay the instrument in some capacity.
- **[Makers???** can appear on the instrument, however some have procedural rights. Accomodation parties are said to be secondarily liable on the instrument (like drawers and indorsers). **So something has to happen first.**
- The maker of a note has none of these rights. The maker of a note has no right to assert a defense unless he is ...to pay ??
- If there are 2+ parties that signed in the same transaction, they are jointly and severally liable
- AND they also have rights of contribution. If one maker is forced to pay the holder , then the co=maker is entitled to their share of the note

Obligation of an Endorser

- Indorsing your name on the back makes an indorser a type of guarantor for all prior parties. It is conditioned upon 1) presentment and 2) notice of dishonor.
- A **special indorsement** names a particular person as endorsee.
- When an instrument is **signed in blank** it doesn't name a particular person. It becomes bearer paper.
- A **qualified indorsement** is w/o liability and signed w/o recourse
- **Restrictive indorsements** are, for example, *for deposit only*.
- **Anomalous indorsements** are made by a person who is not a holder. They only put their name on to be a guarantor.

ACCOMMODATION PARTY

- Surety/guarantor/accommodation party are all the same thing. UCC calls a surety or guarantor an 'accommodation party'
- **Accommodation party**
 - Common-law Rights under UCC:
 - **Exoneration**: They can demand principal/maker have to pay
 - **Subrogation**: If they are forced to pay principal's debt, they are subrogated to rights of creditor
 - **Reimbursement**: Upon paying, can sue principal
 - **Contribution**: Can seek contribution if more than one accommodation party
- **How to you become an accommodation party?** 1) Signing on same instrument and 2) not receiving direct benefit
- **How do you become liable?** Liability is in whatever capacity you sign as an accommodation party e.g., sign in maker's place, you have maker liability
- Although accommodation party is never liable to the party they accommodated. An accommodation party is liable to other parties in the capacity of which the accommodation party signed.

- **What happens when primary obligor/debtor offers to pay on instrument and the offer is rejected? What happens to the liability of secondary obligor?**
 - The **Tender of Payment Rule** states that if, at maturity, a secondary obligor tenders payment to a holder of the instrument, and holder refuses to accept, then the secondary obligor remains liable for the full amount, but not liable for any subsequent interest.
 - The **Tender by Principal Obligor Rule** states that if tender is made by a principal obligor, the secondary obligor (ie, accommodation party) is completely discharged.

- **Impairment of collateral & how it affects secondary obligors**
 - A secondary obligor can stand in the shoes of a creditor if they pay
 - If a holder impairs collateral by failing to take reasonable care of collateral, then the secondary obligor has a claim against them up unto the amount of collateral that was given. This benefit is only available to the secondary obligor; it is not available to a principal obligor.
 - e.g., if \$100K debt was secured by \$80k collateral and creditor failed to perfect it, then the secondary obligor is only liable for \$20k.
 - Only good for secondary obligor... not the principal
- **Agreements b/t the creditor and principal (ie, 1st party that is liable)**
 - Agreement to extend time of payment
 - A secondary obligor is bound by an **extension agreement** when pursuing rights against a principal obligor. They also have the right to receive benefits of the extension agreement in relation to rights against the creditor and the secondary obligor discharged from obligation if he can prove extension caused him some harm/loss.
 - Free to ignore extension and pay creditor on original date.
 - To stop interest
 - Agreement not to sue
 - Agreement to release principal and keep secondary obligor on hook
 - Also discharges secondary obligor liable to creditor unless release clearly says otherwise
 - A secondary obligor cannot pursue the creditor unless spec allows, but the secondary obligor is discharged to the extent he can prove loss caused.
 - Secondary obligor gets benefits of any **modification agreement** and is bound by it in relation to principal. A secondary obligor is discharged to the extent he can prove loss by reason. If the second obligor pays the debt, he may ignore modification and pay according to original terms.

Not a lot of questions about this (accommodation party) on exam

Maybe one about impairment of collateral

If there are Qs, it's going to be "she is discharged to extent she can prove loss"

- If the accommodation party adds words to signature, then before collection can occur ag/ her, the creditor has to go after prim obligor and have to pursue through unsatisfactory judgment or show bankruptcy. Can't just go to prim obligor and they say no... must go after to furthest extent possible.
 - o But accommodation has to have magic language. i.e, "collection guaranteed"

OBLIGATION OF DRAWER

- Drawer promises to pay only if presentment and dishonor
- Possible conditions of contractual obligations
- Indorsers retain significant rights, but d
- Presentment = demand for payment
- Made to who?
 - o Promissory note? Maker
 - o Draft? Drawee
- What auth demands that presenter has to make
 - o When presentment is made, OK to ask to present doc, reasonable ID, sign, surrender, etc.
 - o If presenter doesn't comply, presentment has not occurred--Therefore not dishonor
- Time for presentment
 - o Must be done w/in 30 days from date
 - o If after, indorser is off the hook
- Dishonor
 - o Maker/drawee returns w/o paying or accepting
 - o If presenting across counter, then it must be paid or returned by close of business on that date
 - o Regular checks not over counter or 'on us' – drawee bank has until midnight deadline
- **Notice of dishonor** can be given to any person liable on instrument. It may be given orally. Banks must give notice by expiration they the midnight deadline. Others must give notice w/in 30 days. An endorser is off the hook if they do not receive notice of dishonor.
- Because indorser's obligation is conditioned upon notice of dishonor and presentment, and unless excused then indorser excused if they don't occur
- What about for drawer? Code does not require that drawer be given notice of dishonor or that CKS presented w/in 30 days
 - o Only excused after 30 days if bank b/comes insolvent
- Stale checks
 - o If a **regular check** is presented after 6 months after date, said to be stale.
 - o Bank who dishonors may not be sued for wrongful dishonor
 - o But OK for bank to pay on it, but usually not going to
- Some situations where technical procedural requirements are excused (i.e. dishonor or presentment)
 - o Bank: Circumstances beyond bank's control
 - If bank uses reasonable diligence to avoid problem
 - o All other cases: Can be completely excused if
 - Waiver
 - Unavailability of party. i.e., Maker is dead or in bankruptcy
 - impossibility
 - compliance useless
 - party who stops payment or requests another to do so
- Or a party who stopped payment or requested the right to do so

Obligation of a Drawee

- In sum, a drawee is not liable unless there's 1) acceptance and 2) their signature on what has then become a certified check.
- A drawee incurs no UCC contractual liability b/c no person is liable on an instrument unless they signed the instrument. The drawee only becomes liable when the bank accepted the check and it is signed. Acceptance occurs when the drawee's signed agreement is on the draft, as presented, at which point, it becomes a certified check and they are liable. If the bank accepts the check, then the drawee and indorsers are off the hook.

Liability of an Agent and his Principal

- **Signature Rule:** A drawee incurs no UCC contractual liability b/c no person is liable on an instrument unless they signed the instrument.

Agency Liability

- **Does an agent have authority?** If he signs, he is personally liable unless principal ratifies it/accepts benefits
- Does have authority
 - **Has agent (when signing) named principal and indicated that agent's signature is made in agency capacity?** → If yes, the agent is NOT personally liable
 - If agent has not named principal or that signed in agency capacity → Then always liable to HDC and always liable to anyone else **unless agent can prove that original parties did not intend me to be liable**

/* That's end of suits w/ underlying negotiable instruments. */

Warranties

- Typically doesn't possess instruments
- 3 stages
 - Issuance
 - Transfer
 - Presentment (to maker or payor bank)
- No warranties created by issuance of negotiable instrument

- **Transfer warranties** arise when there is any movement that is a transfer.
 - **6 that are made:**
 - Make a warranty and you are a PEEI Breached if forgery (for example) of payee's name
 - All signatures are authentic and authorized Breached if forged signatures
 - No alterations Breach if any change in terms of instrument (not a forgery)
 - No legal defenses or claims that are good against transferor
 - No legal problems being transferred w/ instrument
 - No knowledge of any bankruptcy proceeding
 - ~~Remotely created consumer items~~ **Not on exam**
 - Warranties depend on receipt of consideration. There is no transfer warranty if no consideration was received. i.e., gifts
 - But might make some kind of indorser liability
 - Parties to whom warranty extended
 - If received consideration, by transferor to immediate transfere

- **Presentment Warranties**
 - **Price v. Neal rule** b/t innocent holder and payor bank/drawee who were both duped by unauthorized signature, drawee must bear loss
 - We have 4 presentment warranties
 - Warrantor is a PEEI
 - No alterations
 - At time of transfer or presentment, presenter had no knowledge that sign of drawer/maker was unauthorized
 - Not strict liability!
 - Forgery is not alteration
 - ~~Remotely created consumer items~~ **Not on exam**

- **How does this work?**
 - **Forged (what?) signature**
 - **Drawee honors**
 - The drawee bank must re-credit the account b/c the item was not properly payable. The drawee bank can recover breach of presentment warranties b/c no one following forged indorsement is entitled to enforce. Those parties may then recover for breach of transfer warranties. The result is that loss is taken back down chain of title to next solvent person.
 - **Drawee dishonors**
 - No drawer liability b/c no one entitled to enforce. Parties may recover for breach of transfer or warranties. Result is that loss is taken back down chain of title to next solvent person following the forgery

 - **Forged Drawers Signature**
 - **Drawee dishonors**
 - No drawer liability b/c drawer never signed.
 - Parties may recover from prior transferor for breach of transfer war
 - Result is that loss is taken back down chain of title to next solvent person following forgery
 - **Drawee honors**
 - Drawee must re-credit the accountt b/c the item is not properly payable.

- Drawee can try to bring claims for breach of transfer warranty but will likely fail b/c everyone was entitled to enforce
- Drawee bank can try to recover in restitution in payment by mistake but not against person in good faith and for value. The result is that the loss is almost always borne by the drawee bank.
- **Conversion** occurs when a) an instrument is stolen, or b) when a depository bank doesn't honor the instructions that state *for deposit only* on an instrument or c) most typically when there's a forged indorsement, § 3-420. Thus, conversion occurs any time forgery of necessary indorsement when such is missing. The result is that all transfers thereafter are conversion.
 - Proper plaintiffs
 - Drawee???

Bank Deposits and Collections

- When someone opens checking account, both UCC 3 & 4 apply. The **Federal Expedited Funds Availability Act (EFAA)** also applies. It tells us how soon bank has to make funds available to customers.
- **2 Important Things To Know**
 - Bank may charge customers account only if item is properly payable
 - Once final payment has been made, payee bank loses right to return item
- **Wrongful Dishonor**
 - A drawer has a cause of action for **wrongful** dishonor if a check or other item is 1) properly payable and 2) the bank refuses to cash or honor it. Only a drawer can sue for wrongful dishonor. Other parties cannot sue unless it is a certified check. Actual and consequential DAS may be given for wrongful dishonor *that causes a loss??*.
 - When a **customer dies or becomes incompetent**: 1) Death does not revoke until bank knows of death and has reasonable time to act on knowledge. 2) Even when it has knowledge bank can continue for 10 days after date of death unless someone with interest says for bank to stop
- **Properly Payable**
 - Bank and customer are following rules in K and sufficient funds in account to pay
 - Insufficient funds? Then bank does not have to honor the check
 - If it chooses to do so → customer liable for overdraft and may be charged a fee
- **Altered and completed items**
 - If a check is altered, the bank may charge a customers account only according to original terms of items of their agreement, unless a customers negligence led to the alteration, in which case, the bank may pay as altered.
 - If a customer leaves blanks that are later filled in, bank may assume it's proper and account charged accordingly
 - A payor bank may charge a customers account only if it pays a PEEL. If it does not, you have proper payment rule... have to re-credit acct.
- **Post-dated checks** are properly payable unless the customer gives notice before bank pays check, otherwise bank can ignore it.
- A **stop payment** is not properly payable.
- A customer *never* has right to place stop payment order on bank checks. (Bank always can pay b/c customer not liable).
- But a customer does have the right to make a stop payment order on a regular check if the customer gives notice with identifying in reasonable time. Oral notice = OK for 14 days. Written notice = OK for 6 mos
- A bank has a **right of offset**. It can subtract \$\$ owed to customer against any debt the customer owes that bank. However, a bank cannot set off any unpaid credit card debts of their customer.
- Bank collection procedures
 - o Funds availability – **Electronic Funds Availability Act**
 - If customer puts \$\$ or CKS in acct, the expedited funds avail act regulates
 - **Regulation cc times:**
 - Govt checks/bank checks: next day availability
 - o Cust also must be able to WD \$200 of day's deposit
 - o Regular checks must be avail not more than 2 days after deposit
 - o Cash WD
 - \$200 on bus day after date of deposit
 - Up to \$300 by 5pm on second day
 - Remainder on next (3d) business day

ONLY UP TO \$5000 (are banks required to release

The Electronic Funds Availability Act (EFAA)

- For the first 30 days, a bank must follow the EFAA and hold the checks... A bank may hold the excess of \$9,000 for a reasonable time (redo. Checks). Sometimes it may if it doubts the collectability of the check. This is called the "deposited availability" under the EFAA.
- If the act is silent on the rules → look to the UCC
- For **money**, a customer may draw a money deposit on an account on the next banking day.
- For **checks** on an item, a customer may on the 2nd banking day.
- There will be no essay questions or short answer on the final settlement or midnight deadline rules.
- The payor bank has until its midnight deadline to dishonor a check through... banking channels... If final payment occurs, then drawers and indorsers obligations are no longer on the hook.
- Prior to final payment, a depository bank or a collecting bank has the right to charge back its customers account.

Check 21

- Just know that under the statute, banks have the right, *not the duty*, as long as the customer agrees to it. If the customer agrees to it, the bank can make a copy of the check.
 - Diff b/w a truncating bank and a reconverting bank
 - Must have mandatory language on the check that says *this is a legal copy of the check* and can use it like any other.

The **imposter** rule states that if drawer or maker are duped → the drawees name is deemed ineffective. The drawees name is validated regard of who forged it

The **Fiction Pay Rule** says that if a person signing the instrument doesn't intend the named payee to have any interest then...

Im. Payee Rule

- All 3 invalidate the forgery
- EE → Responsibility = anything in prep of the I, including bookkeeping,
 - 2 types Invalidated 1) forged indorsements of payees on the checks issued by the EM and 2) EEs name listed on the checks issued to the EM
- The general rule applies when an indorsement is forged by someone who doesn't have authority.
- Negligence can also validate a forgery
 - A person who fails to ex oC is ... precluded from asserting the obligation or the forgery if fails to exercise good faith
 - Ex: blanks on In; mailed to someone negligently named; leaving signature stamp on your desk
 - Oftentimes the bank will win

Under the **Bank Statement Rule**, if a bank choses to send out a statement to its customer then ..

- A customer must use reasonable care in examining 1) an authorized. Sign of their name as the drawer and 2)
- If bank truncating → must send 1) item number 2) amount and 3) date of pymnt
- If C fails to report forgery or alter within a reasonable time → customer is going to be precluded from the bank
- If the statement has been available to the customer for reasonable time, no more than 30 days → C precluded from receiving a recredit
- Bars all C's complaints made < 1 year after the C's statement
- **Alteration** An alteration on an instrument can... If alteration is caused by negligence of a party, the party is not discharged. b/c discharge is a personal defense, still liable under orig terms to HICD. The drawee may charge the altered instrument against original terms.
- complete instrument – unauthorized complet of incomplete = negligent = bank can pay

Electronic Funds Transfer Act (EFAA)/ Truth & Lending Act ***1 s/a on Credit cards

- **Regulation E** governs any transaction where cust uses debit or credit card
- Banks are allowed to mail out unsolicited debit cards as long as not in validated condition. Validated = can be immediately used

- **Error resolution**

- The UCC requires a consumer to report certain problems. A) A consumer must give oral or written notice so notice is received w/in 60 days after institution sends statement. The Banks has 10 days to investigate without re-crediting the customers account. If the banks wants additional time to investigate, it can have up to 45 calendar days as long as it re-credits w/in 1st 10 days (both periods run at same time).
- When unauthorized ETF transfers occur, the consumer will not be liable for more than \$50 of unauthorized EFT. However, there are 2 exceptions: 1) A customer may be liable up to \$500 if they fail to report missing debit card within 2 business days after the card went missing. 2) A customer will be liable for unlimited amount if they fail to report bank statement error w/in 60 days.

Truth and Lending Act and Regulation Z

- A CC may not be issued w/o agreement of consumer. A CC sent to consumer w/o his request is not validly issued. Thus a consumer is not liable unless they accept by signing or using it.

- **Liability for unauthorized use**

- If consumer voluntarily allows someone to use card, consumer liability for all charges even if exceed amount authorized
- Consumer didn't give it to someone for use? Consumer liable no more than \$50

- **Difference between credit cards and debit cards**

- **Credit Cards**

- Cons can assert defenses ag/ merchant. i.e, problem with purchase/item

- **3 rules**

- Cons try to settle problem w/ merchant
- Amount included must exceed \$50
- Has to have occurred in consumers home state or w/in 100 miles of consumer billing add

- **Billing error**

- Contains mistake, RegulZ allows review
- Must be in writing w/in 60 days of bill
- Institution required to investigate w/in 30 days

EXAM TIPS

Class Website on Moodle: <http://online.stcl.edu/course/view.php?id=3152>

Contact Info:

Exam Date: 12/3/2013 6-9 pm

Exam Format:

- Mainly MC + 5 Short answer
- Each short answer problem has 3-4 questions describing the rules. Don't need to cite the §.
- 10-15 minutes per short answer question. Majority could be covered in 5-6 lines
- Similar to the practice problems
- No laptops-write on the test
- Just like the bar
- Closed book
- Review intended to cover big picture issues. There will be little nuisances we won't have time to cover in review.
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