

QUESTION 2

Dennis the Dentist placed an advertisement offering to sell his old dentist chair for \$500. The next week, Bob the Barber read the advertisement and later visited Dentist about purchasing the chair. Because Barber did not have enough cash to make the purchase, he offered Dentist \$50 in cash and a \$500 IOU. Dentist accepted this offer and Barber gave Dentist a signed note which read:

I, Bob the Barber, promise to pay Dennis the Dentist \$500 on or before January 1, 2001.
/s/Bob the Barber
09/15/00

Dentist decided to go to his favorite watering hole to celebrate the sale. He ordered a drink from Bart the Bartender who owned the bar. Bartender refused to serve Dentist because Dentist had an overdue bar tab of \$400. Dentist said to Bartender: "I have a \$500 IOU from Bob the Barber. How about I give it to you and we forget about the bar bill?" Bartender agreed, and Dentist wrote on the back of the note: "Pay to the order of Bart the Bartender" and handed the note to Bartender.

That night, Bartender gathered the day's receipts, including the note, locked the doors of the bar, and headed for his car. When he approached his car, out from behind it jumped Thor the Thief. Thief demanded that Bartender hand over the bar receipts; Bartender did as he was told.

When Thief got home and sorted the loot, he noticed the note. He took the note to his cousin, Willie the Weasel, who agreed to pay Thief \$100 in exchange for it. Thief signed Bartender's name on the back of the note and gave it to Weasel. On January 1, 2001, Weasel presented the note to Barber for payment. Barber refused to pay.

QUESTION:

Discuss the status, rights, and obligations of the parties.

DISCUSSION FOR QUESTION 2

The IOU, signed by Barber, is a promissory note and a negotiable instrument. It is an instrument that is a (1) written, (2) signed, (3) unconditional (4) promise to pay, (5) a fixed amount of money (6) payable to the order of Dentist (7) at a definite time. U.C.C. § 3-104(a). Barber is the maker of the promissory note. U.C.C. §3-103(a)(5). Dentist is the payee on the instrument. U.C.C. §3-104(e).

The instrument was properly negotiated by special indorsement from Dentist to Bartender. U.C.C. § 3-205(a). Bartender is a holder in due course because he took the promissory note: (1) for value, (2) in good faith, and (3) without notice that it was overdue, had been dishonored, or was subject to a defense or claim by any party. U.C.C. § 3-302(a)(2).

Thief is neither a holder nor a holder in due course. In order to be a holder of an instrument, the person must have both (1) possession and (2) a right to enforce the instrument. U.C.C. § 3-301. Because Dentist signed the promissory note with a special indorsement naming Bartender as the payee, further negotiation of the promissory note could only be effected by Bartender affixing his signature to the back of the document (through indorsement). U.C.C. § 3-205(a). Although Thief had possession of the instrument, he had no right to enforce the promissory note without Bartender's indorsement, and thus could not be a holder. U.C.C. § 3-301.

Weasel is also neither a holder nor a holder in due course because he could not enforce the promissory note against Barber. U.C.C. § 3-301. Thief's forging of Bartender's signature breaks the chain of title and no subsequent possessor of the instrument (e.g. Weasel) can qualify as a holder or a holder in due course.

Because the chain of title has been broken, Dentist is within his rights to refuse to pay Weasel when the promissory note was presented for payment. Dentist also has no liability to Bartender because Bartender does not have possession of the promissory note. In order for Bartender to receive payment on the promissory note, he must be in possession and then present it to Dentist for payment.



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Essay 2 GradeSheet

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and write numbers clearly

GENERAL

1. The IOU is a promissory note and as such, a negotiable instrument. 1. _____
2. An instrument is negotiable if it is a (a) written and signed, (b) unconditional promise (c) to pay a fixed amount of money to bearer, or to a designated person, (d) at a future/definite time. 2. _____
3. A holder is a person who has both possession and a right to enforce an instrument. (The note must be payable to bearer, or the person in possession.) 3. _____
4. A holder in due course is someone holder who takes an instrument (a) for value, (b) in good faith, and (c) without notice [that it is overdue, dishonored, or subject to a defense or claim by any party]. 4. _____
5. A special indorsement makes the note payable to a certain person. 5. _____

BOB BARBER

6. Barber is maker of note. 6. _____

DENTIST

7. Dentist is payee of note. 7. _____

BART BARTENDER

8. Bartender became a holder in due course when note indorsed to him. 8. _____
9. Past debt can serve as value. 9. _____

THIEF

10. Thief is neither a holder, nor a holder in due course. 10. _____
11. Thief did not take for value. 11. _____
12. Thief's forging of the indorsement breaks the chain of title; only Bartender could indorse instrument. 12. _____

WEASEL

13. Weasel also is neither a holder, nor a holder in due course. 13. _____
14. Barber is not obligated to pay Weasel on the note. 14. _____

QUESTION 7

Debbie Drawer was fortunate enough to get tickets to a Grateful Dead concert from Sam Scalper. Ms. Drawer wrote two checks to the order of Sam Scalper for the tickets, one for \$100, and one for \$50. Scalper signed the back of the \$100 check with his name. On the \$50 check, he signed the back "Pay to Ricky Receiver" and signed his name, Sam Scalper, below.

Scalper was on his way to give the checks to Ricky Receiver when he was in an automobile accident. He was taken to the hospital and the car was towed to a lot where Terry Tower found the checks. Tower took the checks to Stereo Heaven and paid for a new CD player by endorsing both checks "Ricky Receiver."

QUESTION:

Discuss Scalper's claims against Stereo Heaven for the value of the checks. Do not discuss potential criminal charges against Tower.

DISCUSSION FOR QUESTION 7

This question presents the examinee with issues related to negotiable instruments, pursuant to the Uniform Commercial Code. To be a **negotiable instrument**, the commercial paper must be:

1. An unconditional promise or order,
2. to pay a fixed amount of money,
3. payable to the order of or to the bearer,
4. on demand or at a definite time, and
5. does not state any other undertaking or instruction by the person promising or ordering payment to do any act in addition to the payment of money.

Both checks are negotiable instruments by this definition. (U.C.C. §3-104).

The \$100 check contained a blank endorsement by Sam Scalper. A blank endorsement is one that does not need a specific endorsee. When Scalper signed the check, the instrument became bearer paper. A negotiable instrument created as bearer paper is negotiable by delivery alone (U.C.C. §3-202(a), 3-205(b)). Therefore, when Terry Tower gave the \$100 check to Stereo Heaven, Stereo Heaven became a holder and therefore had good title to it. A **holder** is a person in possession of an instrument drawn, issued or endorsed to him or to the bearer or in blank (U.C.C. §1-201(2)). At the time Stereo Heaven received the check it was bearer paper.

When Stereo Heaven gave value for the check, it became a holder in due course, unless it could be shown that Stereo Heaven acted in bad faith or with notice of a claim against the check (U.C.C. §3-302). A **holder in due course** is a holder who takes the instrument:

1. for value,
2. in good faith, and
3. without notice of any claim or defense on the part of any person.

(U.C.C. §3-302(a)).

The second check for \$50 contained a special endorsement. A special endorsement is one that names a particular person as the endorsee. The endorsee must sign the check for it to be further negotiated. The right to enforce an order instrument will not pass unless the payee's endorsement is authorized and valid. (U.C.C. §3-305 (a)(1) and (b)). In other words, Stereo Heaven could not qualify as a holder without a valid signature by Ricky Receiver. Sam Scalper probably has a good claim against Stereo Heaven for the \$50 check, but not for the \$100 check.



Essay 7 GradeSheet

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1. This question concerns negotiable instruments, UCC Article 3, Commercial Paper. 1. _____
2. A negotiable instrument is commercial paper that contains an unconditional promise to pay a fixed amount to a bearer on demand and has no other conditions. 2. _____
3. Recognition that Scalper's signature on \$100 check was a blank endorsement. 3. _____
 - 3a. Instrument therefore became bearer paper. 3a. _____
 - 3b. Bearer paper is negotiable by delivery alone. 3b. _____
4. The \$50 check contains a special endorsement. A special endorsement names a particular person as the endorsee who must endorse the check. 4. _____
5. Recognition that \$50 check remains order instrument. 5. _____
6. Recognition that forgery of the name on the \$100 check does not prevent Stereo Heaven from being a holder and from having good title to it. 6. _____
7. A holder is a person in possession of an instrument drawn, issued or endorsed to him/her or to the bearer or in blank. 7. _____
8. A holder in due course is a holder who takes for value, in good faith without notice of any claim or defense. 8. _____
9. Stereo Heaven was a holder in due course of the \$100 check. 9. _____
10. Therefore, Scalper's claim probably will be unsuccessful against Stereo Heaven for \$100 check. 10. _____
11. Recognition that Stereo Heaven is not a holder or holder in due course of the \$50 check because of the forgery by Terry Tower. 11. _____
12. Recognition that Sam Scalper may have a claim against Stereo Heaven for the \$50 check. 12. _____

QUESTION 8

Dan keeps his checkbook for his checking account at First National Bank on the coffee table in his living room so he can find it when he needs it. On March 1, 2004, Freddy visited Dan's house and, while Dan was not looking, stole a blank check from Dan's checkbook.

Later, Freddy filled out the stolen check, making it payable to Peter Payee, a neighbor of Freddy's, in the amount of \$500. (Freddy had no intention of giving the check to Peter.) Freddy then masterfully forged Dan's signature as drawer and immediately forged Peter's endorsement on the back of the check. Freddy then gave the check to his niece, Nell, as a birthday present. Nell knew nothing about Freddy's wrongdoing.

On March 15, 2004, Nell took the check to the First National Bank, endorsed it, and gave it to the teller to cash. The teller carefully compared Dan's signature card to Freddy's excellent forgery and, deciding that the signature was authentic, paid Nell \$500 cash.

On April 1, 2004, the Bank sent a checking account statement to Dan which contained the forged check. Dan tossed the statement on his desk without reading it. On October 1, 2004, Dan finally reviewed the statement, discovered the Peter Payee check, and demanded that the Bank credit his account \$500.

QUESTION:

Discuss whether the Bank must credit Dan's account for the \$500.

DISCUSSION FOR QUESTION 8

A bank may charge a customer's account only for items which are properly payable from that account. UCC 4-401(1). If an item is not properly payable, the account owner may insist that the bank credit the account. Ordinarily, checks not bearing the customer's authorized signature as drawer are not properly payable. *See, e.g. Wiley v. Manufacturers Hanover Trust Co.*, 6 UCC 1083, 1084 (N.Y. Sup. Ct. 1969); *Morgan v. First Nat'l Bank*, 58 N.M. 730, 276 P.2d 504, 507 (1954). Generally, an unauthorized signature of the drawer is wholly inoperative to charge the drawer unless he ratifies it or is precluded from denying it. UCC 3-404(1). Thus, in the absence of some sort of preclusion or ratification, the Bank may not charge Dan's account for the amount of the check.

The Bank has two potential preclusion arguments against Dan. First, any person "who by his negligence substantially contributes to...the making of an unauthorized signature" is precluded from asserting that defect if the drawee "pays the instrument in good faith and in accordance with the reasonable commercial standards of the drawee's...business." UCC 3-406.

The Bank appears to have acted in good faith, as it was unaware of the forged drawer's signature. *See* UCC 1-201(19) ("Good Faith" means honesty in fact in the conduct or transaction concerned.") The Bank also appears to have acted in accordance with reasonable commercial standards. It carefully checked the signature on the check against the signature on Dan's signature card and paid only when the two appeared to match. *See, e.g., Ossip-Harris Ins., Inc. v. Barnett Bank*, 428 So.2d 363, 366 (Fla. App. 1983); *K & K Manufacturing, Inc. v. Union Bank*, 628 P.2d 44, 48-49 (Ariz. App. 1981). Given Freddy's "excellent" forgery, it is hard to imagine what more the Bank could have done to detect the forgery. Thus, Dan is precluded from raising the forged drawer's signature if Dan's negligence substantially contributed to the forgery. This raises a fact issue, but it is at least arguable that Dan's practice of leaving his blank checks in public view was negligent and that this negligence substantially contributed to Freddy's forgery of Dan's signature. *See, Thompson Maple Products, Inc. v. Citizen's Nat'l Bank*, 211 Pa. Super. 42, 234 A.2d 32, 35 (1967).

If the Bank does not succeed under 3-406, it might also try to use 4-406 to preclude Dan from asserting the forged drawer's signature. This section imposes on Dan a duty to examine his checking account statement with reasonable care and promptness for, among other things, an unauthorized drawer's signature. UCC 4-406(1). Dan clearly violated this duty when he let the statement sit on his desk for six months before reviewing it. Since the Bank probably exercised ordinary care in paying the check, *see*, UCC 4-406(3), the preclusions of 4-406(2) apply. Dan would be precluded from asserting against the Bank the forged drawer's signature if the Bank "establishes that it suffered a loss by reason of" Dan's failure to examine. UCC 4-406(2) (a). The Bank is unlikely to succeed here because it had already paid the check by the time Dan received the statement, and a timely objection would not have prevented a loss. *See, J. White & R. Summers, Uniform Commercial Code 695* (3d ed. 1988). Section 4-406 also establishes a limitations period within which Dan must report a forged drawer's signature, but Dan has clearly acted within that one-year period. *See*, UCC 4-4

06(4). Thus, 4-406 is unlikely to help the Bank.

Even if Dan is precluded from asserting the forged drawer's signature, Freddy's forgery of Paul Payee's name still creates a momentary problem. The instructions to the Bank were to pay to the order of Paul Payee and the Bank paid neither to Paul nor, because of the forged endorsement, to anyone Paul ordered payment made to. *See e.g., W.R. Grimshaw Co. v. First Bank and Trust Co.*, 563 P.2d 117, 120 (Okla. 1977). However, Freddy's forgery of Paul's name is effective to pass title because Freddy, signing as the drawer, did not intend Paul Payee to have any interest in the instrument. UCC 3-405(1) (b). The fact that Paul Payee is a real person is irrelevant. UCC 3-405, Comment 3 ("The test stated is not whether the named payee is 'factitious', but whether the signer intends that he shall have no interest in the instrument." *See also, J. White & R. Summers, Uniform Commercial Code 701* (3d ed. 1988)). Thus, the forged endorsement does not prevent the check from being properly payable.

ESSAY Q8

SEAT

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ISSUE

	YES	NO
1. A check is a negotiable instrument.	1. <input type="radio"/>	<input type="radio"/>
2. A Bank may not ordinarily charge a Depositor's account without the Depositor's authorization.	2. <input type="radio"/>	<input type="radio"/>
3. A Bank can rightfully pay a check bearing an unauthorized signature if:		
3a. The depositor's negligence (leaving checkbook on coffee table) substantially contributes to the making of the unauthorized signature; and	3a. <input type="radio"/>	<input type="radio"/>
3b. The Bank acts in good faith and in accordance with reasonable commercial standards, such as careful examination of signatures.	3b. <input type="radio"/>	<input type="radio"/>
4. Upon receipt of his bank statement, Dan must act with reasonable promptness to review and notify Bank of irregularities.	4. <input type="radio"/>	<input type="radio"/>
5. Dan's delay of six months to review his statement is within the one year time limitation provided under the UCC.	5. <input type="radio"/>	<input type="radio"/>
6. Nevertheless, the Bank could not prove that it suffered any loss by Dan's failure to act timely since it paid the check immediately.	6. <input type="radio"/>	<input type="radio"/>
7. The forged endorsement of Peter Payee does not prevent the check from being properly payable.	7. <input type="radio"/>	<input type="radio"/>
8. The Bank may not be obligated to credit Dan's account because of Dan's negligence and because the Bank acted in good faith.	8. <input type="radio"/>	<input type="radio"/>
9. The Bank may be liable because Dan notified the Bank of the error within one year of receipt of his statement.	9. <input type="radio"/>	<input type="radio"/>

QUESTION 1

After a successful negotiation with counsel for an insurance company regarding a pending lawsuit, the insurer issued a check for \$30,000 drawn on First Federal Bank. The check was made payable to Paula Plaintiff and Larry Lawyer. Lawyer was Plaintiff's attorney in the suit. The insurer mailed the check to Lawyer, and when Lawyer received the check, he indorsed his name on the back of the check and also signed Plaintiff's name. Lawyer then deposited the check in his lawyer's trust account at Second State Bank. Second State Bank presented the check to First Federal Bank and received payment. The \$30,000 was then credited to Lawyer's trust account.

A few days later, Lawyer withdrew all the funds from the account. Under a valid contingency fee agreement, Lawyer was entitled to one-third of any amount collected in the lawsuit. Lawyer has never remitted any portion of the settlement proceeds to Plaintiff. Second State Bank did not have any reason to suspect Lawyer's withdrawal of funds from the trust account was improper.

QUESTION:

Discuss whether Plaintiff can recover any of the \$30,000 from Second State Bank. Do not discuss any potential actions that Plaintiff might be able to bring against Lawyer.

DISCUSSION FOR QUESTION 1

The check was a negotiable instrument. U.C.C. 3-103 and 104. A negotiable instrument is one that is an: (a) unconditional (b) promise or order (c) to pay a fixed amount of money. In order to be negotiable, the instrument must be payable to order or bearer. U.C.C. 3-109. Here, the check is an order instrument, as it is payable to specific persons.

In order to become a holder of an instrument, a person must be in possession with a right to enforce it. When an instrument is payable jointly it can only be negotiated with the indorsements of each of the named payees. UCC 3-110(d). Unless all the joint payees indorse the instrument, no person taking it up can be a holder or person entitled to enforce the instrument. *See*, UCC 3-201 and 3-301.

A bank converts an instrument if the bank pays it or gives value for it to a person who is not entitled to enforce it. UCC 3-420; CRS 4-3-420(a). Here, Plaintiff may have a cause of action for conversion against Second State Bank. She was a joint payee of the insurer's check. The instrument was payable to her and Lawyer. Her indorsement was therefore necessary to pass title to the instrument. Second State Bank may have converted the instrument when it paid out the sums it collected against the check to Lawyer. The case will turn on whether Lawyer's signing of Plaintiff's name was effective as Plaintiff's signature.

The Uniform Commercial Code recognizes that a person may be bound on an instrument if an agent signs that person's name. UCC 3-401(a). The Code relies on common law agency principles in determining whether a represented person is bound by

an agent's use of the principal's name. UCC 3-402(a). Several courts have held a client liable when an attorney signs the client's name on a negotiable instrument. *See, e.g., Terry v. Kemper Insurance Company*, 390 Mass. 450, 456 N.E.2d 465 (1983); *Hutzler v. Hertz Corporation*, 39 N.Y.2d 209, 347 N.E.2d 627 (1976). These cases reason that as between the client and a financial intermediary like a bank, the client should bear the risk of the attorney's defalcation. A contrary argument, however, can be made on agency principles. The attorney had no authority to sign the client's name. The client also did nothing to cloak the attorney with apparent authority. *See generally, Annotation, Discharge of Debtor Who Makes Payment by Delivering Check Payable to Creditor to Latter's Agent, Where Agent Forges Creditor's Signature and Absconds with Proceeds*, 49 A.L.R. 3d 843 (1973). The examinee should discuss the issue of whether or not Plaintiff's signature was authorized in evaluating potential weaknesses in the conversion claim.

Even if a court finds Lawyer had no authority to sign Plaintiff's name, the court could nevertheless limit Plaintiff's recovery to \$20,000. Under UCC 3-420, liability is presumed to be the amount payable on the check, but recovery may not exceed the amount of the plaintiff's interest in the instrument. Plaintiff is accepting the insurer's offer of settlement. Lawyer would have received \$10,000 of the settlement even if he had not done anything wrong. At common law, it was a defense to any claim on a negotiable instrument that the funds collected against the instrument reached the intended payee. *See, e.g., Florida National Bank v. Geer*, 96 So.2d 409, 412 (Fla. 1957). Second State Bank can argue \$10,000 of the check reached the proper payee, Lawyer. Second State Bank could reach the same result under a subrogation theory. By paying Lawyer, they would be entitled to Lawyer's rights against Plaintiff. *See, UCC 4-407; CRS 4-4-407*. In other words, Second State Bank can argue it acquired Lawyer's right to his fee by subrogation. The examinee should discuss this potential limitation on the amount of Plaintiff's recovery in evaluating her claim.

ESSAY Q1

SEAT

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ISSUE

POINTS
AWARDED

- | | |
|---|-------|
| 1. The check was a negotiable instrument. | 1. ○ |
| 2. A "negotiable instrument" is one that is an <i>unconditional promise or order to pay a fixed amount of money</i> . | 2. ○ |
| 3. In order to be "negotiable," the instrument must be payable to order (a specific party), or bearer. | 3. ○ |
| 3a. Here, <i>check is an order instrument</i> (as it is payable to specified persons). | 3a. ○ |
| 4. When an instrument is payable <i>jointly</i> , it can only be negotiated with the endorsements of <i>both parties</i> . | 4. ○ |
| 5. A "holder" of an instrument is a person in <i>possession</i> of it " <i>entitled to enforce</i> " it. | 5. ○ |
| 5a. Because only Lawyer endorsed the instrument, he is not a holder. | 5a. ○ |
| 6. Second State Bank may be guilty of <i>conversion</i> because it paid the instrument amount to a person not entitled to enforce it. | 6. ○ |
| 7. Issue spotting: Could Lawyer legally sign Plaintiff's name to the instrument? (Was he her agent?) | 7. ○ |
| 7a. U.C.C. adopts an agency theory. | 7a. ○ |
| 8. Court <i>could limit</i> Plaintiff's recovery from Second State Bank to \$20,000 (as contingency agreement allowed Lawyer one-third of \$30,000 settlement). | 8. ○ |
| 9. <i>Subrogation</i> theory would also allow Second State Bank to " <i>set off</i> " the \$10,000 owed to lawyer which he already has in his possession. | 9. ○ |