GRADING GUIDES FOR PAST FINAL EXAMINATIONS IN COMMERCIAL PAPER--PAYMENT SYSTEMS (Course 6282)

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This document contains grading guides for final examinations in Commercial Paper-Payment System (Course No. 282) given on the following dates:

Dec. 12, 2012
Dec. 14, 2011
Dec. 15, 2010
Dec. 13, 2007
Dec. 14, 2006
May 4, 2006
Dec. 16, 2004
Dec. 18, 2003
Dec. 19, 2002
Dec. 19, 2000
Dec. 16, 1999
May 13, 1999
Dec. 18, 1997
Dec. 19, 1996
Dec. 19, 1995

I did not teach Commercial Paper--Payment Systems in 1998, 2001, 2005, 2008, 2009, 2013, or 2014. I do not have grading guides for examinations given before 1995.

When reading the answer guides, please keep the following points in mind:

(1) The coverage of the course changed slightly when new editions of the casebook came out in 2007, 2004, 2000, and 1997. For example, older exams ask questions about bills of lading and warehouse receipts, but the current edition of the casebook does not address these subjects. The older exams also cite cases no longer in the current edition of the casebook.

(2) The law may have changed since the time the exam was given. U.C.C. Articles 1, 3, and 5 all have been amended since 1995. You are responsible for knowing the current law, regardless of what earlier answers said.

(3) The explanations in the answers here often are longer or more complete than what would be expected or necessary on an actual exam answer.

(4) The answers contain various "notes" and parenthetical phrases. Usually, they refer to issues that some students might see, but that went a little beyond the scope of the course.

(5) The exams do not require drawing diagrams of the transactions at issue. But most students find diagrams helpful.

(6) Each of these exams was appropriately difficult. Each produced a wide distributions of scores. Typically, a few students answered nearly all of the questions correctly, while other students had more difficulty. Grades were awarded according to the required grade distribution guidelines.

(7) Incomplete answers or answers that contained some mistakes received partial credit.

(8) Please excuse formatting problems in these answers. They have been converted from one file format to another several times.

The George Washington
University Law School

December 12, 2012

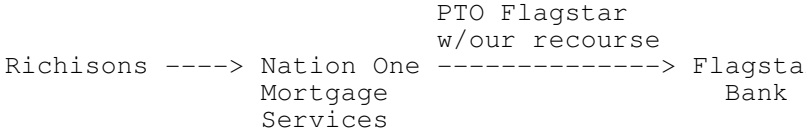
Grading Guide for

COMMERCIAL PAPER--PAYMENT SYSTEMS

(Course No. 6282-20; 3 credits)

Professor Gregory E. Maggs

PROBLEM I. **(26 points)**



A. What must Flagstar do to prove its entitlement to enforce the Note?

Flagstar must prove the validity of the signatures on the instrument and must prove that it is a person entitled to enforce the instrument . See 3-308(b). The validity of the signatures is admitted unless specifically denied. See 3-308(a). And if the validity is denied, there is still a presumption of validity in the absence of proof to the contrary. See 3-308(a). Persons entitled to enforce an instrument include holders. See 3-301(i). Flagstar can prove that it is a holder by producing the instrument (thus proving possession) and showing that the instrument, by indorsement, has been made payable to Flagstar. See 1-201(b)(21)(A).

B. What potential liability did Nation One exclude by signing the Note "without recourse"? What potential liability did Nation One not exclude?

Nation One excluded potential indorser liability--i.e., liability to pay the note if it is dishonored. See 3-415(b). Nation One did not exclude potential liability for breach of warranty--e.g., liability if the signatures are not authentic and authorized, etc. See 3-416(a) & cmt. 5.

C. The Richisons argued in defense that they were not liable on the Note because Flagstar "assumed the risk" of a default. What arguments might Flagstar make in response?

Flagstar could make three arguments. First, Flagstar might argue that it is a holder in due course because it took the instrument in good faith, for value, and without notice of any defense or other problem. See 3-302(a). The facts suggest nothing to the contrary. As a holder in due course, Flagstar would argue that it is not subject to any defenses except the so-called "real" defenses listed in 3-305(a)(1). See 3-305(b). These real defenses do not include "assumption of the risk." 3-305(b).

Second, Flagstar might argue that, even it is not a holder in due course, "assumption of the risk" is not a defense that can be asserted in an action to enforce a negotiable instrument. In addition to real defenses, the only other defenses that can be asserted are defenses "stated in another section of article 3" (e.g., discharge by payment, 3-602(a)), and defenses that could be raised against a person "enforcing a right to payment under a

simple contract." 3-305(a)(1)&(2). Assumption of the risk is not a defense stated in another section of article 3. Therefore, "assumption of the risk" would be a defense only if it is an ordinary contract defense in the jurisdiction--which seems unlikely. Assumption of the risk is usually a defense in a tort action, not a contract action.

Finally, Flagstar will assert that, even if "assumption of the risk" is a possible contract defense, Flagstar did not assume the risk that Richisons would not pay. Why would any holder assume that risk when they are buying an instrument from someone who indorsed it without recourse? The whole point is to receive payment.

D. What might have been some of the advantages and disadvantages to each of the parties in using a negotiable instrument in this transaction instead of an ordinary contract?

Flagstar: Negotiable instruments and ordinary contracts are both transferrable. But all else being equal, Flagstar might prefer to purchase a negotiable instrument instead of taking an assignment of an ordinary contract for three reasons. First, a negotiable instrument is typically easier to enforce than an assigned contract because of the rules in 3-308(a) and (b) cited above. Second, if Flagstar is a holder in due course, the instrument would come free of ordinary contract defenses, claims in recoupment, and competing claims of ownership. 3-305(b). That would not be true of an ordinary contract (unless the ordinary contract contained a waiver of defenses clause). Third, a negotiable instrument by definition is a self-contained, unconditional promise to pay. 3-104(a). If Flagstar bought a negotiable instrument, Flagstar would know exactly what it was purchasing. That said, all else might not be equal in purchasing a negotiable instrument. It might cost more to buy a negotiable instrument than it would to obtain the assignment of an ordinary contract precisely because the negotiable instrument would have all the advantages listed above.

NationOne: If banks like Flagstar would prefer to purchase a negotiable instrument than to take an assignment of an ordinary contract, then Nation One would prefer a negotiable instrument because it would be easier to sell.

Richisons: All else being equal, the Richisons might see the possibility of having claims and defenses stripped away in favor of a holder in due course as a disadvantage to using a negotiable instrument. But on the other hand, they probably would not have received financing from Nation One if they had refused to sign anything but an ordinary contract; Nation One would have worried about the difficulty of reassigning such a contract. In addition, the Richinson's benefitted from the merger doctrine; once a negotiable instrument had been taken for their loan, they would only have to pay a person entitled to enforce the note.

PROBLEM II. (26 points)

Note: I misspelled "Ellerkamp" as "Ellercamp" in the questions. I have used the correct spelling below.

A. What arguments should Flavor Finish and Ellerkamp make regarding whether Ellerkamp is personally liable?

Ellerkamp should argue that he is not personally liable on the instrument because he unambiguously signed the instrument in a representative capacity. 3-402(b)(1). Ellerkamp will assert that the inclusion of the word "by" before his name and the inclusion of his title after his name show that he was signing as an agent of e2 Real Estate Partners III, LLC, and not in his personal capacity.

Flavor Finish should argue that Ellerkamp is personally liable. To prevail, Flavor Finish first must show that it is ambiguous whether Ellerkamp signed in a representative capacity. 3-402(b)(2). The Suttles case says that only ambiguities in the signature block matter. One arguable ambiguity is that the signature block is for a "guaranty" but e2 Real Estate Partners III, LLC is identified in the signature block as the borrower rather than the guarantor. This opens the possibility that Ellerkamp is the guarantor. Second, if the signature is ambiguous, Flavor Finish next must prove (with extrinsic evidence) that the parties intended Ellerkamp to be personally liable. Flavor Finish should argue that it would make no sense for e2 Real Estate Partners to guarantee its own loan; the parties therefore must have intended Ellerkamp to be acting as a guarantor.

B. What advice would you have given Flavor Finish in preparing the note and signature block?

Flavor Finish would like both e2 Real Estate Partners III, LLC and Ellerkamp to be liable on the note so that it could recover the full amount from either one of them. Flavor Finish therefore should ensure that the signature block unambiguously shows that e2 Real Estate Partners III, LLC is the maker of the note and that Ellerkamp in his personal capacity is the guarantor. The signature block therefore might look something like this:

Borrower: _____
e2 Real Estate Partners III, LLC, by John M. Ellerkamp, Manager

Guarantor: _____
John M. Ellercamp

C. If Ellerkamp is held to be personally liable, what rights would he have upon paying Flavor Finish?

A guarantor is presumed to be an accommodation party. See 3-419(c). There is also no evidence that Ellerkamp received a direct benefit from the loan. 3-419(a) & cmt. 1. As an accommodation party, if Ellerkamp paid Flavor Finish, Ellerkamp would have a right to reimbursement from e2 Real Estate Partners III, LLC for any amount that he pays. See 3-419(f). He would also acquire any lien or other security interest that Flavor Finish might have against the property of e2 Real Estate Partners III, LLC. See 3-419 cmt. 5.

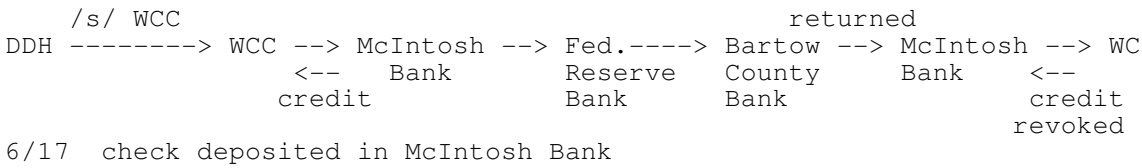
Note: If Ellerkamp personally received a benefit from the loan (there are no facts on this point), then he would not be an accommodation party. 3-419(a). As a result, he would have a right to contribution rather than reimbursement. See 3-116(b). The facts say that 3 of 12 payments have already been made. If Ellerkamp paid the remaining 9/12 of the note, he could recover 6/12 of the note in contribution.

D. Why is it customary for the owner of an incorporated small business to sign notes made by the business in both a representative and non-representative capacity?

Lenders are more willing to lend money if they are more likely to be repaid. They are more likely to repaid if the incorporated small business and the owner are each liable. From the lender's perspective, the more people and identities who are liable the better. See textbook, p. 93.

PROBLEM III. **(26 minutes)**

Bartow County
Bank, PTO WCC
$60,452



6/17 check deposited in McIntosh Bank
6/18 check presented to Bartow County Bank
Bartow County Bank debits DDH's account
6/19 McIntosh Bank credits WCC's account
Bartow County Bank returns check and places hold on DDH account
6/22 Fed. Reserve Bank receives
-/-- McIntosh Bank debits WCC's account

A. Is Bartow County Bank (the Bank) accountable for the check?

No. A payor bank is "accountable" for a check if the bank does not return the check by its midnight deadline. See 4-302(a)(1). Bartow County Bank's midnight deadline is midnight of the day after the day that the bank received the check. 4-104(a)(10). Bartow County Bank received the check on 6/18. Its midnight deadline was on midnight of 6/19. Bartow Bank met this deadline because it returned the check on 6/19.

B. May McIntosh Bank debit WCC's account for the amount of the check?

Yes. McIntosh Bank did not receive a final settlement in this case because the check was returned by Bartow County Bank. As the depositary bank, McIntosh Bank may revoke a provisional credit for a check if it fails to receive final settlement for the check. See 4-214(a). But if the depositary bank fails to revoke its midnight deadline or a longer reasonable time, it is liable for any loss resulting from the delay. See id. The facts do not indicate the timing of the debit in this case.

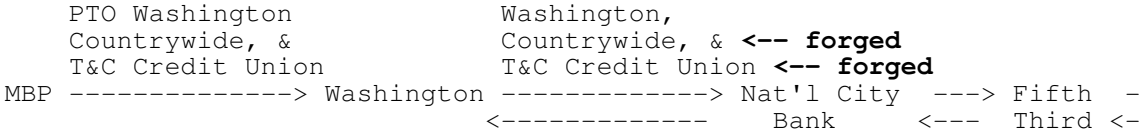
C. What rights does WCC have against DDH?

WCC can enforce the check against DDH. The drawer of a check is liable if the check is dishonored. See 3-414(b). In addition, WCC can assert any underlying contract or other claim for which the check was taken. Although the underlying claim was suspended when the check was first taken, the suspension ended when the check was dishonored. See 3-310(b)(3).

D. Might DDH have a claim against any party?

DDH might have a claim against Bartow Bank for wrongful dishonor of the check. Dishonor of a properly payable check is wrongful unless honoring the check would have created an overdraft. 4-402(a). It is unclear from the facts whether honoring the check would have created an overdraft at the time the check was dishonored. The facts suggest that the account had funds but that the Bank dishonored the check so that it could transfer funds out of DDH's account to pay a debt owed to the Bank. If the bank had no right to transfer these funds, the dishonor would be wrongful.

PROBLEM IV. **(26 points)**



$$ $$ Bank $$

A. Is Fifth Third Bank liable to MBP?

Yes, absent some contrary agreement, Fifth Third Bank is liable to MBP. This check was payable to Washington, Countrywide, and T & C Federal Credit Union. To be negotiated to National City Bank, it therefore had to be indorsed not only by Washington but also by authorized representatives of both Countrywide and T & C Credit Union. See § 3-110(d). Washington's indorsement was authorized but the other indorsements apparently were not.

A bank may charge a customer's account for a check only if it is properly payable unless some exception applies. See 4-401(a). A check is not properly payable unless the drawer's signature and indorsements are authorized. See id. Because this check contained unauthorized indorsements on behalf of Countrywide and T & C Federal Credit Union, the check was not properly payable.

The facts do not suggest that any exceptions the properly payable rule might apply. The exceptions for reporting delay do not apply because MPB had no duty to report unauthorized indorsements to Fifth Third. A bank customer has a duty to report only the "alteration of an item" or the "purported signature by or on behalf of the customer [that] was not authorized." 4-406(c). The facts also do not suggest any exception for customer negligence. 3-406(a). There is no reason to presume that it was negligent for MBP to issue a check to one of the payees of the check.

B. Do Countrywide Home Loans and T & C Federal Credit Union have conversion or other claims against any party?

Yes. National City Bank and Fifth Third converted the check by "mak[ing] or obtain[ing] payment with respect to the instrument" because Washington was "a person not entitled to enforce the instrument." 3-420(a). As explained above, no one was entitled to enforce the instrument absent an authorized indorsement by Countrywide and T & C Federal Credit Union.

The exception that prevents payees from bringing conversion actions does not apply because that exception applies only to "a payee . . . who did not receive delivery of the instrument . . . through delivery to . . . a co-payee." 3-420(a). In this case, Countrywide and T & C Credit Union received delivery of the instrument through delivery to their co-payee Washington.

Countrywide Home Loans and T & C Federal Credit Union also may have a conversion claim against Washington. Section 3-420(a)'s first sentence says that the law of conversion applicable to personal property applies to negotiable instruments. Under the laws of most states, conversion consists of the wrongful disposition of property. Washington wrongfully disposed of the check in which Countrywide Home Loans and T & C Federal Credit Union had rights when she (or an accomplice) forged their indorsements and deposited the check.

C. If the check had been dishonored and returned to Washington, what rights would Washington have?

Washington could not enforce the check against MPB because Washington would not be a person entitled to enforce. The check would still be payable to three parties and two of them would not have indorsed the instrument. As explained above, their forged indorsements were ineffective.

In addition, although the check was dishonored, Washington cannot recover from MBP on the underlying obligation for which the check was taken.

The underlying obligation was suspended by the check. 3-310(b). The suspension did not end when the check was dishonored because the "obligee of the obligation for which the instrument was taken [was not] the person entitled to enforce the instrument." 3-310(b)(3).

D. Why were the antifraud measures insufficient to prevent payment of this check? Could they have been improved?

The antifraud measures were insufficient to prevent payment of the check in this case because the measures did not enable either Fifth Third or MPB to detect unauthorized indorsements. The antifraud measures required MBP to verify that every check that was presented to Fifth Third was in fact a check the MPB had issued. The measures thus prevented anyone from forging MPB's signature on a check or altering the amount of the check. The problem here was not a forged drawer's signature or alteration but instead unauthorized indorsements.

Improving the antifraud measures would be difficult. Even if the antifraud procedures had shown MPB the indorsements, MPB would have had no way of knowing what the signature of the various payees of its checks look like. It is for this reason that, absent some exception, liability for checks with forged indorsements does not fall on the drawer or the payor bank but instead falls on the depositary bank. Fifth Third therefore has little reason to improve the antifraud measures.

PROBLEM V. (26 points)

Chavez -- customer
Gutierrez -- Employee of Mecantil Bank
Originator -- Chavez or someone else?

A. Under what circumstances might Mercantil Bank have a right to charge Chavez's account for the funds transfer?

First, Mercantil Bank can charge Chavez's account if the payment order was authorized. See 4A-202(a). The payment order in this case would be authorized if the person who entered Mercantil Bank to make the payment order was either Chavez or Chavez's agent. Gutierrez will testify that the person was Chavez because Gutierrez examined the person's passport. Chavez apparently will testify that it was not him but was instead an impostor. The jury will have to decide who is more credible. As the facts indicate, there is no video tape or other similar extrinsic evidence.

Second, even if the fund transfer was unauthorized, Mercantil Bank can charge Chavez's account if the payment order was "effective" because it passed a reasonable security procedure. See 4A-202(b). "Comparison of a signature on a payment order or communication with an authorized specimen signature of the customer is not by itself a security procedure." See 4A-201 (emphasis added). The security procedure here did require comparison of a signature, but that was only part of the procedure. The procedure also required the originator to appear in person and present an identification. That might be a commercially reasonable security procedure depending on banking practices. If it is a commercially reasonable security procedure, and the procedure was followed, then the payment order was effective.

But even if the payment order was effective, it would be unenforceable if Chavez can "prove that the order was not caused, directly or indirectly, by a person (i) entrusted at any time with duties to act for [Chavez] with respect to payment orders or the security procedure, or (ii) . . . or who obtained, from a source controlled by [Chavez] and without authority of the receiving bank, information facilitating breach of the security procedure."

§ 4A-203(a)(2). Chavez may have difficulty proving this given that no one knows who caused the payment order.

B. Might Mercantil Bank have a claim against anyone besides Chavez?

If Mercantil Bank can recover from Chavez because the payment order was either authorized or effective, then Mercantil Bank does not have a claim against anyone else. Its sole remedy is to charge Chavez for the payment order, which it already has done. 4A-402(c).

If Mercantil Bank must reimburse Chavez because the payment order was neither authorized nor effective, Mercantil Bank might have claims against both the perpetrator of the fraud and the beneficiary of the payment order (although it is unlikely that Merchantil Bank can identify them). If the perpetrator sent a payment order which Mercantil Bank accepted, Mercantil Bank would have a right to payment from the perpetrator for the payment order just as it would have a right to payment from any sender of a payment order. See 4A-402(c). Mercantil Bank alternatively could recover from the beneficiary under a theory of restitution. See 4A-203 cmt. 3; 4A-205(a)(2).

C. Did the FTA create a greater risk of funds transfer fraud than an ordinary checking account creates of check fraud?

The risk that check fraud would be attempted is probably greater than the risk that funds transfer fraud would be attempted under the FTA. To attempt check fraud, a thief merely has to forge the customer's signature on a check. To attempt a funds transfer fraud under the FTA, the thief must forge the customer's signature on a payment order and appear in the bank with a false identification document. The thief might be afraid of being caught.

The risk that check fraud will not be dectected by the payor bank is also probably greater than the risk that funds transfer fraud under the FTA will be undetected by the originator's bank. Payor banks examine almost no drawer signatures on checks. Espresso Roma. Under the FTA, the originator's bank will examine the signature and the identification documents of the thief.

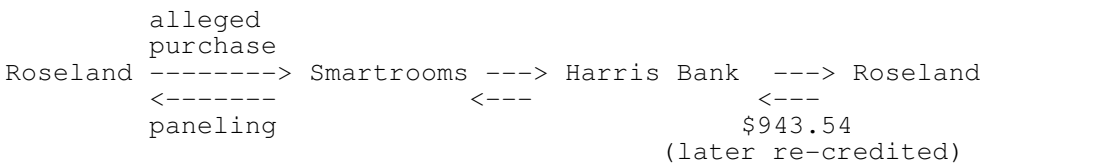
But the risk that a customer will suffer a loss from check fraud that has occurred may be less than the risk that the customer will suffer a loss from funds transfer fraud under the FTA. The customer can avoid a loss from check fraud by proving that the customer's signature on a check was forged (unless the bank can show an exception applies). 4-401(a). In contrast, the customer can avoid a loss from funds transfer fraud under the FTA only by showing that the security procedure (checking the signature and identification) was not followed. 4A-202(a). In this case, even if a forged signature was not detected, Mercantil Bank will argue that the procedure was followed.

D. How might the security procedures have been improved for written payment orders delivered in person?

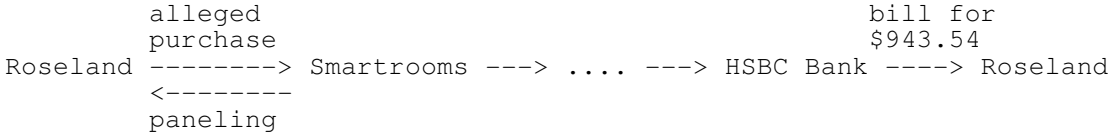
The security procedures appear to have involved examining the originator's signature and examining the originator's passport. The bank also could have required the use of "algorithms or other codes, identifying words or numbers, encryption, callback procedures, or similar security devices" in its security procedure. 4A-201(a). For example, it might have required the originator to use a password, answer security questions, or swipe a card and enter a PIN. In addition, the bank also could have retained its internal videos for a longer period.

PROBLEM VI. (25 points)

DEBIT CARD



CREDIT CARD



A. What advice would you give Roseland for challenging the charge on his credit card?

Roseland could challenge the charge on his credit card simply by sending a notive to HSBC Bank and by not paying. If Roseland does not pay the full amount of the charge, the most likely consequence will be that HSBC will cancel the credit card and file a negative credit report against him. HSBC also may refer the full amount of the charge to a collection agent.

HSBC could seek to collect the full amount of the charge either through a lawsuit or through arbitration (arbitration might be required in the card agreement). But two factors make this unlikely. First, the amount in controversy is only $943.54; a lawsuit might not seem worth it. Second, in a lawsuit or arbitration, HSBC will have the burden of proving the charge was authorized, and HSCBC does not have much evidence. The trier of fact will weigh Roseland's testimony against testimony of a witness from Smartrooms. Smartrooms' documentary evidence--a contract for previously performed cabinetry--appears to be irrelevant. In addition, Smartrooms may lack credibility because it clearly acted improperly by charging both Roseland's credit card and debit card for the one transaction.

If the charge was authorized, Roseland is liable for the full amount of the charge. Both HSBC Bank and Smartrooms believe that the charge was authorized. If the charge was unauthorized, Roseland would still be liable for $50, see 15 U.S.C. 1643(a)(1)(B), unless HSBC by contract agreed to waive this liability for unauthorized charges (as many card issuers do).

Roseland alternatively could file a complaint with the Office of Comptroller of the Currency Consumer Assistance Group, as described in the syllabus appendix. Given the small amount in question, HSBC might decide to forego a dispute with the OCC by charging back the amount of the charge to Smartrooms.

If HSBC charges back the amount of the charge to Smartrooms, Smartrooms then could bring an action for breach of contract against Roseland for not paying for the panel. But Smartrooms would have the same difficulty of proof in this contract action as described above.

Roseland should not use the paneling delivered by Smartrooms because deriving a benefit from the panel could be deemed as authorizing the charge. 15 U.S.C. 1602(p).

B. Did Roseland have greater protection from fraud on his debit card than his credit card?

The protection from fraud is similar on both cards, but the practicalities of asserting the protection are different.

Roseland is generally protected from large losses from fraud in connection with his credit card. As described above, under 15 U.S.C. 1643(a)(1)(B), Roseland would be liable for a maximum of $50 for the unauthorized use of his credit card. His actual liability may be less because many card issuers often waive their right to collect $50 for unauthorized charges. That said, the risk of loss may be greater in some cases because some courts say a "cardholder's failure to examine credit card statements that would reveal fraudulent use of the card constitutes a negligent omission that creates apparent authority for charges that would otherwise be considered unauthorized under the TILA." Citibank v. Minskoff. But that was not the issue here.

Roseland similarly is protected from large losses from fraud in connection with his debit card, provided that he reports them promptly. He can be held liable for a maximum of $50 or $500 depending on whether he fails to report "the loss or theft of the access device" within two days. Reg. E., 205.6(b)(1) & (2). He also could be liable for additional charges if he does not examine his statement. Reg. E., 205.6(b)(3). In addition, it is not clear that he has any liability if the fraud does not involve a lost or stolen debit card.

In general, the practicalities of addressing fraud may be easier in a credit card transaction than a debit card transaction. With a credit card transaction, the consumer can withhold payment and force the bank to take an action to collect the money. The credit issuer often will side with the customer and charge back to the merchant the amount of the disputed charge. With a debit card transaction, the money has already been removed from the customer's account and the customer must persuade the bank or bring an action against the bank to get it back. In this case, however, the opposite was true: it was easier to have the debit reversed than to have the credit card charge removed.

C. Would the charge on the credit card be authorized if Roseland retained and used the paneling?

Yes. If a charge is "for his benefit" it is authorized even if it was otherwise made without actual or apparent authority. See 15 U.S.C. § 1602(p).

D. How can consumers protect themselves from incidents like this?

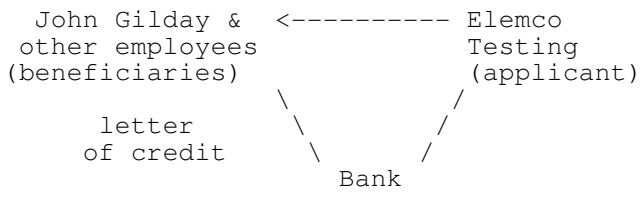
If Roseland is telling the truth, then Smartrooms somehow was able to charge Roseland's credit cards and debit cards without his authorization. It is possible that Smartrooms obtained the card information when Roseland entered into the previous cabinetry contract and retained the information for later use. It is also possible that Roseland gave the information to Smartrooms when he was still considering the paneling sale.

Some protection can come from giving out credit card and debit card information only to reputable merchants. Once the merchant has the information, the credit cardholder has to trust that the merchant will only use it for one charge. The cardholder could ask the merchant whether the credit card information will be retained. (Some credit card issuers will give consumers a one-time use card number when they are worried about merchants.) Consumers also can refuse to give any card information until they have decide to make a purchase.

In addition, consumers also can choose to do business with card issuers whom they trust to take their side in a dispute (as Harris Bank did here, but HSBC did not).

Note: Some answers provided good advice, but the advice did not address incidents like this.

PROBLEM VII. **(25 points)**



A. May the Bank assert an agreement between Elemco and Gilday and the other employees as a basis for refusing to honor the letter of credit?

No. Under the independence principle, any such agreement would be independent of the letter of credit and could not affect the rights of Elemco and Gilday on the letter of credit. See 5-103(d).

B. Could the Bank alternatively have refused to honor the letter of credit because the presentation did not comply?

An issuer must honor a presentation "that, as determined by the standard practice . . . appears on its face strictly to comply with the terms and conditions of the letter of credit" but must dishonor any other presentation. See 5-108(a). In this case, the wording of the presentation is slightly different from what the letter of credit required in that it contains the additional words "to EIB." Evidence of standard practice would be necessary to determine whether this minor variation would be regarded as violating the strict compliance rule. See 5-108(e).

Some courts, however, have adopted a specific standard for conformity. They have held that a bank should not dishonor a non-conforming presentation unless a "bank could have been misled by the discrepancy." Carter Petroleum. In this case, whether the Bank might have been misled might depend on whether funds were owed only to EIB or instead were also owed to others.

C. If the Bank paid the letter of credit, what rights would it have?

If the Bank properly honored the letter of credit, it could seek reimbursement from Elemco Testing. See 5-108(i)(1). If Elemco Testing had a claim against Gilday and the other employees (which seems unlikely), the bank would be subrogated to this claim. See 5-117(a).

If the bank improperly honored the letter of credit, and could not obtain reimbursement from Elemco Testing, presumably it could seek restitution of the payment from Gilday and the other employees.

D. What advice would you have given the Bank in the formation and performance of this transaction?

In forming this standby letter of credit transaction, good advice might have been for the bank to consider whether obtaining reimbursement from the applicant was likely in the event that the bank had to pay the letter of credit. Given that the bank would pay the beneficiaries only in the event of Elemco Testing's bankruptcy, the likelihood of obtaining reimbursement would seem to be in question. The bank perhaps should have required some security to ensure that it could obtain reimbursement from Elemco Testing notwithstanding the bankruptcy. (Perhaps it did and we just do not know about it.)

In performing the letter of credit, good advice might be that the Bank should not deny payment of a conforming presentation. If the presentation is conforming, the Bank will ultimately be held liable for wrongful dishonor and will have to pay not only the amount of the letter of credit but also attorney's fees. See 5-111(e).

The George Washington University Law School

December 14, 2011

Grading Guide for

Final Examination In

COMMERCIAL PAPER--PAYMENT SYSTEMS

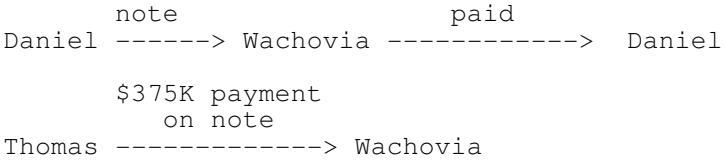
(Course No. 6282-10; 3 credits)

Professor Gregory E. Maggs

In problems I-V, questions A and B were worth 7 points, and questions C and D were worth 6 points. In problems VI and VII, question A was worth 7 points, and questions B, C, and D were worth 6 points. This comes to a total of 180 points.

PROBLEM I.

The edited excerpt in this problem came from Manley v. Wachovia Small Business Capital, 349 S.W.3d 233 (Tex. App. 2011).



A. If Daniel defaulted on the note by not making installment payments, under what circumstances would Wachovia have an immediate right to full payment of the note?

Wachovia would have an immediate right to payment if Wachovia was entitled to enforce, Daniel had not cured the default, and the note contained an acceleration clause. Most home mortgage notes contain an acceleration clause requiring the entire amount of the unpaid principal, arrears, and fees to be paid if a default is not cured within a specified time. For example, clause 6(c) of the Sample Home Mortgage Note (Syllabus Appendix Item #5) says: "If I am in default, the Note Holder may send me a written notice telling me that if I do not pay the overdue amount by a certain date, the Note Holder may require me to pay immediately the full amount of Principal which has not been paid and all the interest that I owe on that amount."

B. If Thomas in fact paid Wachovia, what risks did he face in allowing the bank merely to promise to send him a receipt?

Thomas faced at least three risks. First, Wachovia might deny that it had received payment (as Wachovia apparently has done in this case) and sought to enforce the note, and a judge or jury might be more inclined to believe the bank than Thomas. Second, after receiving the payment, Wachovia might have negotiated the note to a holder in due course, who would take the note free of the defense that the note had been discharged by payment. §§ 3-

305(a)(2),(b), 3-602(a). Third, Thomas could not know whether Wachovia still possessed the note at the time of payment; if Wachovia had previously negotiated the note to someone else, Thomas might have paid the wrong person, and might not have received a discharge. § 3-602(a); Lambert v. Barker.

Note: With respect to the third risk, the revised § 3-602(b), enacted in 10 states, would limit the last possibility by saying that a payment to a person formerly entitled to enforce the instrument will discharge the instrument if the maker has not received notice that the instrument has been transferred. In addition, the federal Real Estate Settlement Procedures Act requires the borrower to be notified in writing of the sale or transfer of any "federally related mortgage loan," which includes most home mortgages. 12 U.S.C. § 2605(b)(1). See Syllabus Appendix Item #1, note (2).

C. What are more secure ways of acknowledging full or partial payment of a note?

Section 3-501(b)(2)(iii) identifies the standard, secure ways of acknowledging full or partial payment of a note: The person paying the note may require the person presenting the note to "sign a receipt on the instrument for any payment made or surrender the instrument if full payment is made." If a receipt is signed on the instrument, anyone taking the instrument will know that it has been paid and cannot become a holder in due course. § 3-302(a)(2). If the note is surrendered, then no one can enforce the note. § 3-301. But as also discussed in class, these more secure ways of acknowledging payment may not have been available to Thomas or Daniel as of right. Most home mortgage notes waive the right to presentment of the note. For example, clause 9 of the Sample Home Mortgage Note (Syllabus Appendix Item #5) says: "I and any other person who has obligations under this Note waive the rights of Presentment . . . ." Still, Thomas and Daniel could have asked the bank for one of these things.

Note: If Thomas merely had wanted written evidence of payment, Thomas could have paid the $375,000 by check or funds transfer rather than cash. Although this method would prevent the bank from asserting that it never received payment, it would not protect him if the note was subsequently negotiated to a holder in due course or had previously been transferred to some third-party (the second and third risks noted above).

D. In a suit by Wachovia against Daniel to enforce the note, what arguments should Daniel make?

Daniel should make two arguments. First, Wachovia at this time is not a person entitled to enforce the note under § 3-301. Wachovia is not a holder or non-holder in possession with the rights of a holder because Wachovia does not have possession of the note. Wachovia is also not a loser because it cannot show that the note "was destroyed, its whereabouts cannot be determined, or it is in the wrongful possession of an unknown person." 3-309(a)(1)(3). Second, Daniel has a defense to payment, namely, that liability on the note has been discharged by Thomas's payment. § 3-602(a). See DCM Limited Partnership v. Wang; Lambert v. Barker.

PROBLEM II.

The edited excerpt in this problem came from 1/2 Price Checks Cashed v. United Auto. Ins. Co., 344 S.W.3d 378 (Tex. 2011).

	PTO Patrick, Brandy & DBD	Patrick, Brandy & DBD				
UAIC ---------->	Half-Price	---------->	Half-Price's	--> UAIC's Bank -->	Half-Price's	--> Half-Price

Bank Bank

Note: In the edited excerpt, when the court says that Half-Price's bank "presented the check . . . for acceptance," it probably should have said "presented the check . . . for payment."

A. What rights, if any, would Patrick Bretton, Brandy Bretton, DBD Motor, or UAIC have upon paying or repaying Half-Price?

If one of the indorsers--Patrick Bretton, Brandy Bretton, or DBD Motor--repaid Half-Price, the indorser paying would have a right of contribution from the other indorsers, § 3-116(a)&(b), and would have a right to enforce the check against UAIC, § 3-414(b)'s second sentence.

If UAIC paid the check, UAIC would discharge its obligations both on the check and the underlying obligation for which the check was issued. § 3-602(a) & § 3-310(b)(1). But UAIC would not acquire any rights against the Brettons or DBD Motor because the drawer acquires no rights against the indorsers upon paying the check. See § 3-415(a)'s second sentence (specifying the liability of indorsers).

B. What liability, if any, does UAIC's bank have to each of these parties?

UAIC's bank could be liable to UAIC for wrongful dishonor, unless it has some proper ground for not paying the check not indicated by the facts. § 4-402(a) & (b).

UAIC's bank is not liable to any of the other parties for dishonoring the check (unless something happened, such as missing its midnight deadline in returning the check, which is not indicated by the facts), because the drawee is not liable on the instrument until the drawee accepts it. § 3-408

C. What rights do the Brettons and DBD Motor have against UAIC under the automobile insurance agreement?

Under the merger doctrine, when the Brettons and DBD Motor first took the check, their rights to payment from UAIC under the automobile insurance agreement were suspended. § 3-310(b). But once the check was dishonored, the suspension of their rights ceased, and they could recover either on the check or the underlying obligation. § 3-310(b)(3).

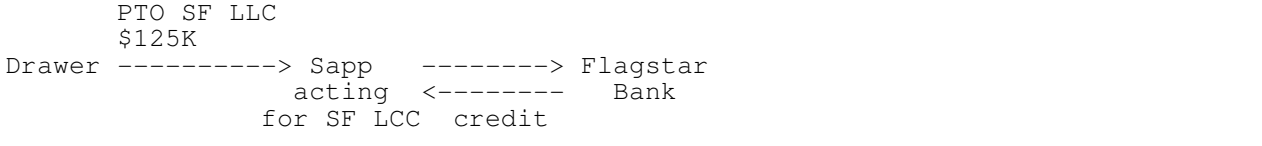
D. If the Brettons and DBD Motor had not indorsed the check when they cashed it at Half-Price, how would the lack of indorsement have affected Half-Price's rights?

The absence of indorsement would make Half-Price a transferee rather than a holder. § 3-203(a). As a transferee, Half-Price would still be entitled to enforce the check against UAIC as a non-holder in possession with the rights of a holder. § 3-301(ii). Half-Price, however, would have to prove through testimony how it acquired the status of a non-holder in possession with the rights of a holder. § 3-308(b) & § 3-203 cmt. 2. In addition, Half-Price could not be a holder in due course and would be subject to any defenses that UAIC might have.

Half-Price could not recover from the Brettons and DBD Motors based on their indorsements, see § 3-415(a), because they would not have indorsed. The facts do not suggest any warranty that the Brettons and DBD Motors might have breached. § 3-416(a). Unless otherwise agreed, however, Half-Price would have a specifically enforceable right to have the Brettons and DBD Motors indorse the instrument. 3-203(c).

PROBLEM III.

The edited excerpt in this problem came from Sapp v. Flagstar Bank, 956 N.E.2d 660 (Ind. App. 2011).



Aug. 23 $125K credit given to SF LCC
Oct. 27 $125K credit revoked, creating a balance of -$123,093.65

A. Did Flagstar Bank have a right to charge back the credit that it had given to SF LLC for the deposited check?

Yes. Flagstar Bank has a right to charge back the credit because it failed to receive a final settlement for the check. A depositary bank always has the right to revoke a provisional settlement and charge back the credit given if it "fails by reason of dishonor, suspension of payments by a bank, or otherwise to receive settlement for the item which is or becomes final." § 4-214(a); Essex Construction v. Industrial Bank. In this case, Flagstar Bank "otherwise" failed to receive a settlement.

Flagstar Bank, however, may be liable to SF LCC for damages. If a depositary bank delays in sending notice beyond its midnight deadline or a longer reasonable time, "it is liable for any loss resulting from the delay." § 4-214(a). The facts do not suggest any loss that the delay in this case might have caused. But the loss might include the value of the check if the check can no longer be collected but could have been collected earlier (e.g., the drawer went bankrupt).

Note: On the specific issue of revoking the credit, it does not matter that Flagstar Bank cannot return the item, that Flag Star Bank failed to act promptly, that SF LCC withdrew the credit, or that Flagstar Bank was negligent. The depositary bank can revoke by sending notice "whether or not it is able to return the item." § 4-214(a). In addition, "[i]f the return or notice is delayed beyond the bank's midnight deadline or a longer reasonable time after it learns the facts, the bank may revoke the settlement [and] charge back the amount of any credit given for the item to its customer's account. . . ." Id. "The right to charge back is not affected by: (1) previous use of a credit given for the item; or (2) failure by any bank to exercise ordinary care with respect to the item."

Note: SF LCC continues to own the lost check because the settlement for the check never became final. § 4-201(a). Accordingly, SF LCC has a claim against Flagstar Bank for return of the check. § 3-306. If Flagstar Bank cannot return the check because the check has become lost, Flagstar presumably would be liable to SF LCC. But the liability would not be for the full value of the check because SF LCC could still enforce the check (or be given the right to enforce the check) as a loser. 3-309(a). Damages might only equal the cost of an lost instrument indemnity bond.

B. Under what circumstances, if any, might Sapp have an incentive not to identify the drawer of the check?

Sapp does not have a clear incentive not to identify the drawer of the check. Sapp and the drawer are both liable to Flagstar Bank. In fact, Sapp would seem to have an incentive to reveal the identity of the drawer. If Sapp does not identify the drawer, then Flagstar Bank's only recourse is to seek

the money from Sapp. Moreover, if Flagstar Bank recovered from the drawer, Flagstar could not recover from Sapp. (Sapp is liable to Flagstar Bank because Flagstar Bank can revoke the credit as explained above, § 2-214(a), and the drawer is liable to the Flagstar Bank because Flagstar Bank can enforce the check against the drawer as a loser, §§ 3-301(iii), 3-309(a), 3-414(b).) Of course, there may be some facts we don't know about. For example, if Sapp forged the check or obtained the check or a replacement check through some kind of fraud, Sapp might want to keep the facts secret. But the problem does not suggest anything like that happened.

C. To what extent, if any, would identifying the drawer of the check help Flagstar Bank?

Flagstar would have the right to enforce the check as a loser against the drawer of the check. § 3-301(iii); § 3-309(a).

D. How would the rights of the parties be different if Flagstar Bank had presented the check for payment, and it was the payor bank who lost the check and was unable to identify the drawer?

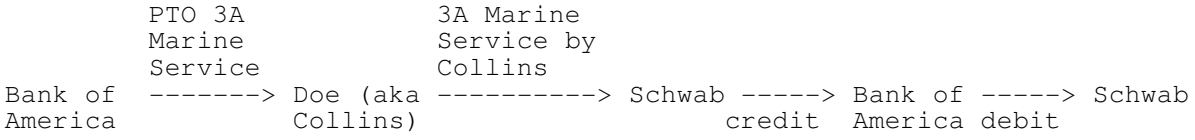
Flagstar Bank and SF LLC's rights would be different because Flagstar Bank no longer could revoke the credit given to SF LLC. As explained above, a depositary bank may revoke only if it fails to receive a final settlement. § 4-214(a). If the payor bank lost the check after it was presented, then the payor bank could not return the check by its midnight deadline, and all of the prior settlements for the check would become final. § 4-301(a). Flagstar Bank thus would have received final settlement.

The liability of the drawer would not be different. The drawer would still be liable on the check, but as a practical matter still would not suffer any loss. The payor bank could not charge the drawer for the check if it could not identify the drawer.

Note: The payor bank might seek repayment of the settlement under a theory of restitution. § 3-418(a). But the Price v. Neal exception presumably would prevent recovery in restitution if SF LCC and Flagstar Bank took the check in good faith and for value or relied on the settlement in good faith. § 3-418(c).

PROBLEM IV.

The edited excerpt in this problem came from Charles Schwab & Co., Inc. v. Bank of America, 2011 WL 1753805, 74 UCC Rep. Serv.2d 541 (N.D. Cal. 2011).



A. Did Bank of America have a right to recover the payment that it had made to Schwab?

Yes. Bank of America made the check payable to 3A Marine Service, a real company. Doe's indorsement on behalf of 3A Marine Service was unauthorized because Doe did not work for 3A Marine Service. Accordingly, Schwab did not become a holder of the check and was not entitled to enforce the check. Bank of America therefore had a right to recover from Schwab for

breach of the presentment warranty that it was entitled to enforce the check. §§ 3-417(a)(1); 4-208(a)(1).

Note: The impostor exception does not apply because Doe did not impersonate 3A Marine Service or a real person who actually had authority to act for 3A Marine Service when he obtained the check from Bank of America. Instead, he told Bank of America that he would give the check to 3A Marine Service. § 3-404(a); Title Ins. Co. v. Comerica Bank.

Note: Schwab might argue that Bank of America was negligent in not determining the true identity of Doe before making him a loan, that this negligence substantially contributed to the making of the unauthorized indorsement, and that Bank of America therefore should be precluded from asserting that the indorsement was unauthorized. § 3-406(a). But if Bank of America was negligent in issuing the check to Doe, Schwab was even more negligent in allowing him to open an account in the name of 3A Marine Service without determining whether he was an authorized agent. Accordingly, Schwab would have to share the loss. § 3-406(b).

B. What rights, if any, might Schwab now assert?

Schwab would have a right to recover from Doe for breach of the transfer warranty that all signatures are authentic and authorized because Doe's signature on behalf of 3A Marine Service was not authorized. § 3-416(a)(2). But Schwab presumably cannot find Doe at this point (that's why he is called Doe).

C. What factors made this fraudulent scheme successful? Why might Doe have thought obtaining a check from Bank of America (as he did) was better than simply using a forged check to open an account at Schwab?

For the scheme to succeed, Doe needed to have Schwab give him credit that he could withdraw before the fraud was detected.

If Doe had forged a check on someone else's account, the fraud might have been detected very quickly. A forged check might have bounced because it was detected as a forgery prior to payment based on the drawer's signature (which might have been examined given the amount of the check) or because the victim's account was insufficient to cover the amount of the check (which was very large). Even if the check did not bounce, the victim might have noticed the large unauthorized debit to his or her account quickly and promptly notified the drawee, who would have immediately notified Schwab.

In contrast, because Doe used a check issued by Bank of America, it most likely too longer to discover the fraud. The check would not be detected as a forgery because it was not forged. The check would not bounce because Bank of America would have enough money to pay it. And Bank of America would not think it odd that its account was debited for the amount of the check because Bank of America wrote the check. Bank of America would only discover the fraud when it learned that the check was not really used to purchase a boat from 3A Marine Service. That might have happened when Doe failed to make a payment on the loan or when 3A Marine Service learned that Bank of America was trying to record a security interest on one of its boats.

In addition, Schwab was more likely to give Doe prompt credit for a cashier's check than Schwab would have given Doe for a personal check that Doe had forged.

D. How should Bank of America and Schwab have tried to prevent this fraud?

Bank of America should have made greater efforts to determine the true identity of Doe before making a loan to him. For example, Bank of America

could have required that he provide identification or called his place of employment determine whether he was who he claimed to be. (Bank of America probably did call 3A Marine Service to determine whether someone named Collins was buying a boat; most likely, Doe went to 3A Marine Service and told them he was buying a boat, but of course he later did not show up with the check.)

Schwab also should have made greater efforts to determine the true identity of Doe. In addition, Schwab should have made greater efforts to determine whether Doe had authority to act for 3A Marine Services. Schwab, for example, could have contacted 3A Marine Services to determine whether anyone named Andrew Collins worked for the company. (Schwab may have presented forged documents showing that he was employed by 3A Marine Service.)

PROBLEM V.

The edited excerpt in this problem came from Experi-Metal, Inc. v. Comerica Bank, 2011 WL 2433383, 74 UCC Rep. Serv.2d 899 (E.D. Mich. 2011):

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            payment
            orders
Perpetrator -------> Comerica ---> .... ---> Beneficiaries
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A. Is it possible for Experi-Metal to obtain cancellation of any of the payment orders?

The originator has a right to cancel a payment order until a reasonable time before it has been accepted. 4A-211(a); Aleo v. Citibank. These payment orders have been accepted by Comerica, so Experi-Metal does not have a right to cancel.

The originator's bank can agree to cancel the originator's payment order after it has executed the order. § 4A-211(c)(1). But Comerica would not agree to cancel these payment orders unless the intermediary bank would agree to cancel Comerica's payment orders, and the intermediary banks would not agree unless the beneficiary's banks agreed. The beneficiary's banks can agree to cancel because the beneficiaries were not entitled to receive payment from the originator. § 4A-211(c)(2)(ii). But it seems unlikely that the beneficiaries would agree to cancel because they probably cannot recover the money from the beneficiaries, who were likely a part of this fraudulent scheme.

B. On what grounds might Comerica argue that Experi-Metal is liable for the payment orders?

Although these payment orders were not authorized, Comerica may argue that they are "effective" because they were verified under a security procedure requiring the confidential secure information and login information that Experi-Metal's employee provided to the perpetrator. § 4A-202(b). Comerica will further argue that Experi-Metal cannot invoke the exception that sometimes makes effective payment orders "unenforceable" because the perpetrator obtained the information necessary to defeat the security procedure from Experi-Metal. § 4A-203(a)(2).

C. Could Experi-Metal recover from Comerica in tort if it could show Comerica was negligent in not stopping the fraud when it had advance notice of the phishing scheme and could observe the large number of suspicious transfers?

No. Article 4A most likely would displace any common law tort claim for negligence. The Official Comment to § 4A-102 says that "resort to principles

of law or equity outside of Article 4A is not appropriate to create rights, duties and liabilities inconsistent with those stated in this Article." As our textbook clarifies on page 200, "the courts appear[] to hold that (1) Article 4A does not preempt common-law causes of action in all cases, but that (2) preemption will be determined in each case by the extent to which the rules of Article 4A occupy the field covered by the particular common-law cause of action." See also Grain Traders v. Citibank; Textbook, pp. 199-200. Article 4A-202 and 4A-203 would appear to occupy the field on the issue of when a customer bears the loss for fraudulent payment orders. Claims for negligence causing the payment of fraudulent payment orders would thus be precluded.

D. In what ways could Experi-Metal and Comerica attempt to prevent this type of fraud from succeeding in the future?

A simple telephone call to Comerica could have determined whether the emails were legitimate or not. In addition, Experi-Metal needs to educate its employees about phishing schemes and how to avoid falling prey to them. Experi-Metal could adopt policies about when bank information is revealed. In addition, Experi-Metal might agreed with Comerica about limiting the funds transders that can be made from its account.

Comerica could educate its customers on the dangers of phishing. It could also put in safeguards to prevent this kind of fraud. For example, it could notify its customers when it learns that they are being targeted by phishing schemes. In addition, Comerica could program its computers to reject suspicious payment orders, much like credit card issuers stop credit cards when they suspect possible fraud. (There is generally no liability for refusing to accept a payment order.) Payment orders might be deemed suspicious if they are out of the ordinary for a particular customer based on the number of payment orders within a particular period, the size of the payment orders, or the beneficiaries of the payment orders.

PROBLEM VI.

The edited excerpt in this problem came from People v. Valentine, 2010 WL 1694101 (Cal. App. 2010).

A. What are the likely liabilities of Kasper, Target, and the issuers of the credit cards for the charges?

Kasper is liable to the issuer for the first $50 of the unauthorized charges, but is not otherwise liable. 15 U.S.C. § 1643(a)(1)(B).

The issuer likely can charge back the amount of the unauthorized charges to Target under standard credit card agreements. See textbook, p. 147.

If Target can deactivate the stolen gift cards before they are used, then no one will suffer a loss.

B. Suppose the thief had instead stolen a debit card and checkbook and used the debit card and forged checks to make purchases. How would the parties' liabilities be different?

Debit Cards

Kasper's liability would not be different for unauthorized charges on his debit card. A consumer is liable for only $50 of unauthorized charges on a debit card if the consumer notifies the issuer within 2 days, which Kasper did. 12 C.F.R. § 205.6(b)(1).

We did not adequately cover this issue in class, but Target and the issuer's liability would also be the same. The issuer can charge back to the merchant liability for unauthorized debit card purchases where the debit card is physically presented, as it would be at Target.

Forged Checks

Kasper's liability, however, would be different for forged checks. The bank could not charge Kasper for a check on which the thief forged Kasper's signature because the check would not be properly payable. § 4-401(a). It does not appear that Kasper's was negligent, given that he locked the locker containing his wallet, and therefore he would not precluded from asserting the forgery. § 3-406(a).

If Kasper's bank dishonored the checks (as it should), the Target's bank could revoke any credit given to Target and Target would bear any loss. § 4-214(a). But if Kasper's bank paid the checks, then it most likely could not push the liability back to the depositary bank and to Target because of the Price v. Neal exception. § 3-418(c). Kasper's bank would bear the loss.

C. Would Kasper's liability be different under questions (A) and (B) if he had negligently failed to lock his locker?

Kasper's negligence would not affect his liability on a credit card or debit card because neither 12 U.S.C. § 1643(a) nor 12 C.F.R. § 205.6(b)(1) take the cardholder's care or lack of care into account in establishing liability for unauthorized charges or debits. (An exception created in Minskoff v. Citibank may make a cardholder liable for subsequent charges if the customer fails to report unauthorized charges after receiving notice but that did not happen in this case.)

Kasper's negligence could affect his liability on a forged check. If Kasper's negligence substantially contributed to the forgery and the bank was not negligent, Kasper would be precluded from asserting that the forged signature was unauthorized, § 3-406(a), and his bank could charge his account for the check if the bank paid it, § 4-401(a). Buf if Kasper and the bank were both negligent--for example, if Kasper told the bank about the forgery but the bank paid the check anyway, the loss would be allocated between them based on their respective fault. § 3-406(b).

D. From the perspective of the thief, what were the strengths and weaknesses of the criminal scheme in this case?

One strength of the scheme was that high volume merchants like Target generally make no effort to determine whether a customer using a credit card actually has authority to use the card. Another strength of the scheme was that the thief used the stolen card quickly before the cardholder or the issuer could identify the problem and invalidate the card.

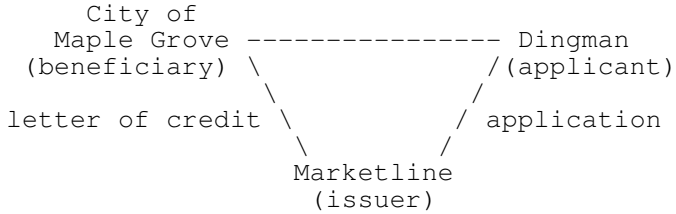
A weakness of the scheme is that stores like Target generally have security cameras and computers that keep track of all purchases, which might lead to the thief's identification. Another weakness is that Target also probably has the information necessary to trace or invalidate the gift cards. In addition, the fitness club might have a record of everyone who accessed the locker rooms on the day of the theft because members, employees, and guests probably had to sign in.

The thief might have done better just to remove one credit card from the wallet and left everything else (perhaps delaying detection) and then used the credit card to purchase expensive items that would not raise suspicion, that could not be traced, and that the thief might easily use (like gasoline or

food) or might easily fence (liquor, cigarettes, electronics, etc). Or he might have tried something better than credit card theft, like the perpetrators in Problems V and VI did.

PROBLEM VII. (25 points)

The excerpt in this problem comes from City of Maple Grove v. Marketline Const. Capital, LLC, 802 N.W.2d 809 (Minn. App. 2011):



A. Why did the parties seek to use standby letters of credit instead of commercial letters of credit?

A standby letter of credit is like a guaranty of the applicant's performance; the issuer typically pays the beneficiary upon a presentation indicating that the applicant did not properly perform (e.g., an affidavit saying the applicant defaulted upon a lease). A commercial letter of credit is a method of making payment; the issuer typically pays the beneficiary upon a presentation indicating that the beneficiary properly performed (e.g., a bill of lading showing that a seller shipped goods). See Textbook, p. 375. In this case, City of Maple Grove, the beneficiary, wanted payment from Marketline, the issuer, only if Dingman Development, the applicant, did not complete and pay for certain improvements. This transaction called for using a standby letter of credit.

B. Marketline argued the documents were not in fact letters of credit based on the language above. Is Marketline correct?

No. Marketline is incorrect. The language of the letter of credit provides for payment upon a documentary presentation (i.e., a certificate purportedly signed by the city administrator saying that Dingman failed to installed and pay for petitioned items), not upon the existence or non-existence of facts (i.e., whether Dingman actually failed to install and pay for the items). See 5-102(a)(10); Wichita Eagle v. Pacific Nat'l Bank.

C. If Marketline had issued documents that do not meet the definition of letters of credit, would Marketline have no liability?

No. If the documents did not meet the definition of a letter of credit, a court might construe the documents to be an ordinary guaranty, rather than a letter of credit. See Wichita Eagle v. Pacific Nat'l Bank. Marketline would be liable on the guaranty, but only in the amount of the actual liability Dingman owes the City of Maple Grove. See Textbook, p. 385. Marketline also could raise defenses arising out of the underlying transaction. Id. Courts have rejected the idea that guarantees issued by banks are void as ultra vires because banks are barred from issuing guarantees. Id.

D. Suppose Dingman Development defaulted on its obligations and the three documents are in fact letters of credit. What rights would Grove City [(sic) should read City of Maple Grove] have?

City of Maple Grove could recover from Dingman Development on the underlying obligation to install and pay for the petitioned items. Under the independence principle, Maple Grove's rights were not suspended. 5-103(d).

Maple Grove alternatively could obtain payment from Marketline by presenting the necessary documents. § 5-108(a). Maple Grove could recover for wrongful dishonor if Marketline did not pay. § 5-111(a).

The George Washington University Law School

December 15, 2010

Grading Guide

for the Final Examination in

COMMERCIAL PAPER--PAYMENT SYSTEMS

(Course No. 282-20; 3 credits)

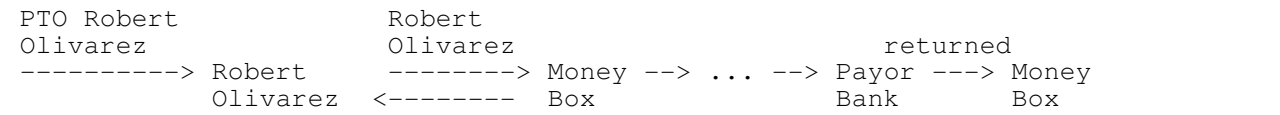
Professor Gregory E. Maggs

INTRODUCTION

I used this guide in grading all the examinations in this course. The explanations in this guide often are longer or more complete than what would was expected or necessary on an actual exam answer. The answers contain various "notes" and parenthetical phrases. Usually, they refer to issues that some students might see, but that went a little beyond the scope of the course. The examination instructions did not require drawing diagrams of the transactions at issue. The diagrams included here serve only to provide clarity. Incomplete answers or answers that contained some mistakes received partial credit.

PROBLEM I.

The edited excerpt in this case comes from Zamora v. The Money Box, 2009 WL 2050207 (Tex. App.).



A.

The Money Box must prove that it is a holder in due course to enforce the check against Southern Plumbing because Southern Plumbing has a defense of failure of the consideration (i.e., Robert Olivarez did not do the work he promised to do). The Money Box has the burden of proof. § 3-308(b).

The Money Box can prove that it is a holder simply by showing that it has possession of the instrument and that it is payable to the Money Box. § 1-201(b)(21). The signatures on the instrument will be deemed to be authentic and authorized unless Southern Plumbing denies their validity, which seems unlikely. § 3-308(a).

The Money Box can prove that it is a holder in due course by presenting evidence that it took the instrument in good faith, for value, and without notice of claims or defenses. § 3-302(1). Money Box might establish this proof with testimony regarding how it acquired the check. It seems likely that Money Box acted in good faith, had no notice, and took for value; it was

simply cashing what appeared to be a pay check, as it routinely does in its business.

B.

The Money Box may recover from Robert Olivarez based on his indorsement, unless Olivarez indorsed without recourse. § 3-415(a). Olivarez also breached the transfer warranty that the instrument was not subject to a defense. § 3-416(a)(4). But the breach of this warranty will not have caused the Money Box any damages if it can recover from Southern Plumbing based on the indorsement. § 3-416(b).

Southern Plumbing would appear to have a contract claim against Olivarez for failing to do the work for which he was paid. Southern Plumbing also might have a tort claim against Olivarez for apparently fraudulently telling Southern Plumbing that he had destroyed the check; Southern Plumbing would argue that it relied on that representation in not requiring Olivarez to return the check.

C.

A bank that wrongfully refused to pay a cashier's check or teller's check that it has drawn must pay attorney's fees. § 3-411(b) & cmt. 2. But the drawer of an ordinary check does not. In this case, Southern Plumbing would not have to pay attorney's fees because it was not the drawer of a cashier's check or teller's check.

D.

Southern Plumbing should have asked Robert Olivarez to return the check rather than simply accepting his word that he had destroyed it.

Although businesses sometimes must advance funds to contractors -- and therefore sometimes must take the risk that they will pay and the work will not be done -- they should be careful not to advance funds to untrustworthy people.

PROBLEM II.

The edited excerpt in this case comes from Citibank (South Dakota), N.A. v. Maniaci, 2009 WL 865605 (N.Y. Dist. Ct.).

A.

Yes. Although Maniaci has attempted to use the check to achieve an accord and satisfaction, an accord and satisfaction can be achieved only if "the amount of the claim was unliquidated or subject to a bona fide dispute." 3-311(a)(ii). In this case, Maniaci concedes that the charges are correct.

B.

The quoted language from the credit card agreement does not appear to have any effect. Although a party sometimes can take an action while reserving rights under the U.C.C., this privilege "does not apply to an accord and satisfaction." 1-308(b).

C.

Citibank and Northland Group could enforce the $925 check against Maniaci as the drawer. § 3-414(b). Alternatively, they could enforce their claim for the entire $4905.05 amount of the credit card debt against Maniaci. Although the debt was suspended, to the extent of $925 when the check was taken, the suspension ceased when the check was dishonored. § 3-310(b)(1).

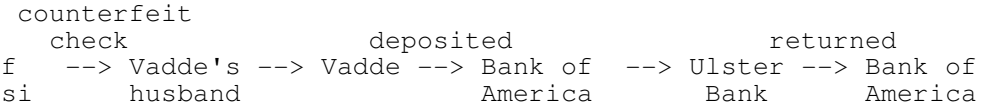
Note: As noted above, there was no accord and satisfaction because Citibank's claim was not subject to a bona fide dispute. If Maniaci's check had been dishonored, that would be another reason that there was no accord and satisfaction because § 3-311(a)(iii) requires the claimant to obtain payment.

D.

No. Although a credit card issuer may charge back to merchants unauthorized charges or charges subject to defenses, under standard agreements the credit card issuer takes the credit risk that the cardholder cannot repay the amount of the card. Textbook, p. 171.

PROBLEM III.

The edited excerpt in this case comes from Vadde v. Bank of America, 687 S.E.2d 880 (Ga. App. 2009).



June 14: Vadde deposits check in Bank of America
June 16-July 8: Vadde writes checks and transfers funds
July 8: check returned by Ulster Bank

A.

The problem says to assume that the Ulster bank is not a local paying bank with respect to the check. Under Regulation CC § 229.2(w), that means the check is a non-local check. Accordingly, Bank of America had to give $100 credit by the next business day, $5000 by the fifth business day, and the rest within a reasonable time. § 229.10(c)(vii)(A) (next day availability); § 229.12(c)(1)(i) (5th day availability); § 229.13(b) & (h)(2) (large deposit exception).

Note: Regulation CC also contains an exception (not discussed in class) for check for which there is "reasonable cause to doubt collectibility." § 229.13(e). A check identified as potentially part of a Nigerian check fraud scheme might fit within this exception.

B. [REVISED]

If Bank of America presented the check on or after July 7 (or earlier if July 7 was a holiday), then Ulster Bank met its midnight deadline and is not accountable for the check. Ulster Bank can revoke any settlement given to Bank of America. 4-301(a)(1).

On the other hand, if Bank of America presented the check before July 7 (or earlier if July 7 was a holiday), Ulster Bank may have missed its midnight deadline. If Ulster Bank missed its midnight deadline, it would be accountable for the check. 4-302(a)(1). Ulster Bank could not revoke any settlement with Bank of America. Ulster Bank also could not recover for

breach of a presentment warranty from Bank of America unless Bank of America knew that the check contained a forged drawer's signature. 4-208(a)(3). Ulster Bank likewise could not recover from Bank of America in restitution because of the Price v. Neal exception. 3-418(c).

The date on which Bank of America presented the check to Ulster Bank might be relevant in determining Vadde's rights against Bank of America. A collecting bank must exercise ordinary care in presenting a check. § 4-202(a)(1). Vadde might argue that a negligent delay by Bank of America injured her by making her believe that the check would not bounce.

C.

Bank of America would have the right to enforce the check against the drawer (which might be Chief Sanusi or someone else who forged his signature). § 3-414(b) (liability of drawer); § 3-403(a) (liability for unauthorized signature).

Bank of America could revoke the credit from Vadde's account because the check was dishonored. § 4-214(a). Bank of America could also recover from Vadde for breach of the transfer warranty that all signatures on the check were authentic and authorized. § 4-207(a)(2).

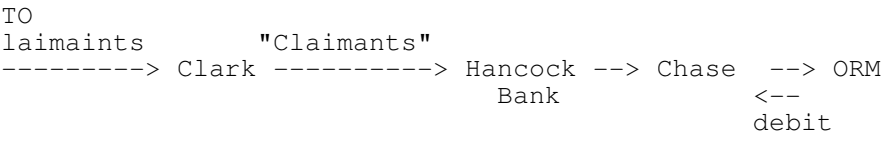
Bank of America could enforce the check against Vadde's husband based on his indorsement. § 3-415(a). If Vadde gave her husband consideration for the check, her husband also would have made and broken a transfer warranty to Bank of America that all signatures on the check were authentic and authorized. § 4-207(a)(2).

D.

For the scheme to succeed (for the perpetrators), three conditions seem necessary. First, the victim must believe the story and be willing to deposit the check. Not everyone is so gullible. Second, unless the victim already has a great deal of money in his or her account, the depositary bank must give credit to the victim before the depositary bank learns the checks has bounced. That is most likely to happen when the bank trusts the victim and the payor bank is located far away. Third, the victim must wire funds out of the account before learning that the credit for the check has been revoked. Some victims might wait before wiring the money, perhaps thinking that they will keep it for themselves. The perpetrators probably hope that if they approach numerous victims, they will get lucky and in some cases all of the conditions will be met.

PROBLEM IV.

The edited excerpt in this case comes from State, Div. of Admin., Office of Risk Management v. Chennel Lite, 2008 WL 5377646 (La. App.).



A.

Yes. Chase may charge an account for checks that are properly payable. § 4-401(a). Checks are properly payable if they are authorized. Id. The issue here is whether Clark's indorsements in the name of the claimants would

be deemed authorized. Section 3-405(b) says: "For the purpose of determining the rights and liabilities of a person who, in good faith, pays an instrument or takes it for value or for collection, if an employer entrusted an employee with responsibility with respect to the instrument and the employee or a person acting in concert with the employee makes a fraudulent indorsement of the instrument, the indorsement is effective as the indorsement of the person to whom the instrument is payable if it is made in the name of that person." In this case Chase entrusted Clark with responsibility because it gave Clark "responsibility . . . to supply information determining the names or addresses of payees of instruments to be issued in the name of the employer." 3-405(a)(3)(iv). Her indorsements are therefore effective as the claimants' signatures, the checks are properly payable, and Chase may charge ORM's account for them.

Note: If Clark is "a person whose intent determines to whom an instrument is payable" then the checks would be payable to nominal payees and would also be properly payable for that reason. 3-404(b)(2). The person whose intent determines to whom a check is payable is determined by the person who signs the check as the drawer. 3-110(a). The facts suggest that someone other than Clark signed the checks as the drawer and that Clark merely suggested the names.

B.

Hancock would be a holder of the checks because Clark's indorsement is effective as the indorsement of the payees for the reasons stated above. As the holder, Hancock could enforce the checks against ORM as the drawer, § 3-414(b), or against Clark as the indorser, § 3-415(a). In addition, Hancock Bank could revoke any credit given to Clark for the checks. § 4-414(a).

C.

The strengths of the scheme were that the checks were issued in the name of real claimants with potential claims and that Mrs. Clark had the power to decide who should received the checks. The checks thus would not have appeared suspicious to auditors looking at ORM's accounts.

The weaknesses were that Mrs. Clark mailed the checks to a post office box that she controlled and she deposited them in a checking account in her name. Once the fraud was detected, it was therefore easy to trace the checks to her.

It might have been better to mail the checks to an address that could not be linked to her and to cash the checks at check cashing facilities where she would remain anonymous.

D.

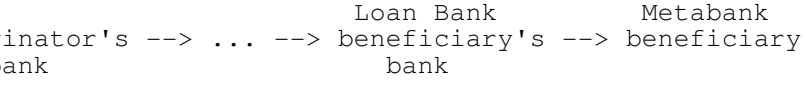
Mrs. Clark requested that her employer, ORM, send settlement checks to the victims. She could have just as easily requested her employer to send fund transfers instead of checks. She would have given her bank account at Hancock Bank as the destination of the funds transfers.

With respect to liability, ORM's bank could charge ORM for wire transfers because they would authorized by ORM (even though this authorization was ultimately the result of Mrs. Clark's deceit). ORM could recover the money from Mrs. Clark on a theory of fraud or restitution. ORM could not recover the money from Hancock Bank. Hancock Bank would have no duty to see whether the beneficiary's names matched the account number. § 4A-209(b). It also would not be liable in restitution because it has given the money to Mrs. Clark.

The ease of detection probably would not change much. Just as an auditor might note that numerous checks were mailed to the same P.O. box, an auditor might notice that numerous funds transfers were sent to the same bank with the same bank account number. It would not take long to trace the transfers back to Mrs. Clark.

PROBLEM V.

The edited excerpt in this case comes from Guardian Angel Credit Union v. MetaBank, 2010 WL 890448 (D.N.H.).



A.

Metabank was the "beneficiary" in the transaction, not a "receiving bank." A receiving bank is a "a bank to which [a] sender's instruction is addressed." § 4A-103(a)(4). No one ordered Metabank to make issue any payment order, and therefore it did not fail to execute a payment order. § 4A-103(a)(1).

B.

Federal Home Loan Bank, not Metabank, was the beneficiary's bank. § 4A-103(a)(3). The beneficiary's bank is "the bank identified in a payment order in which an account of the beneficiary is to be credited pursuant to the order." Metabank was the beneficiary. It did not receive any payment order.

C.

The question here is whether Metabank or Pickhinke are liable "on the certificate of deposit." (Other forms of liability, although perhaps interesting, are not relevant to this question.) Under § 3-401(a), a person is not liable on an instrument unless the person signed the instrument or unless a representative signed the instrument and the signature is binding on the represented person.

The facts suggest that Pickhinke purported to sign the CD on behalf of the bank. Under § 3-402(a), if a person "purporting to act . . . as a representative signs an instrument . . . the represented person is bound by the signature to the same extent the represented person would be bound if the signature were on a simple contract." In this case, Guardian Angel might argue that Pickhinke had apparent authority to bind the bank because the bank put her in a position that made it look like she had authority. See Textbook, pp. 187-87 (describing the apparent authority principle). Ms. Pickhinke might be liable if she failed to indicate that she was signing in a representative capacity, § 3-402(b)(2), but that seems very unlikely.

D.

Even if Guardian Angel had indorsed the instrument "without recourse, "and thus disclaimed its indorser liability, § 3-415(b), Guardian Angel would still make a transfer warranty if it transferred the instrument for consideration and did not write "without warranties," § 3-416(a), (c) & cmt. 5. If Pickhinke's signature was not authorized, it breached the warranty that

"all signatures on the instrument are authentic and authorized." § 3-416(a)(2).

PROBLEM VI.

The edited excerpt in this case comes from Volovnik v. Benzel-Busch Motor Car Corp., 2010 WL 3629819 (S.D.N.Y.)

A.

A cardholder is liable for the authorized use of a credit card but is only liable for unauthorized use up to a total $50. 15 U.S.C. 1643. A charge is unauthorized if the person using the card does not "not have actual, implied, or apparent authority for such use and . . . the cardholder receives no benefit." 15 U.S.C. 1602(o).

Volovnik will argue that Benzel did not have authority to make a charge for the damage to the loaner car because he never gave Benzel authority and indeed explicitly told Benzel that it did not have authority . Chase will argue that the charge is not unauthorized because Volovnik received a "benefit" for the charge, namely, the discharge of his liability to Benzel.

B.

Benzel could charge back the amount of the charges if they were unauthorized (see above), if Volovnik has any valid defense to the services provided by Benzel, or if the charge exceeded the credit limit (which it allegedly did here). See Textbook, p. 171.

C.

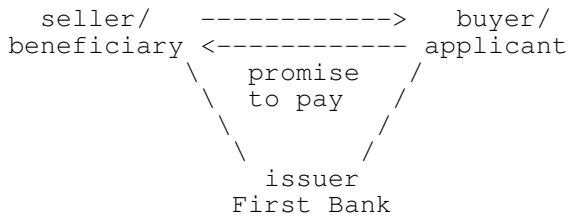
Most credit card agreements provide that the parties can choose to arbitrate their disputes. See Syllabus Appendix No. 11. In addition, Volovnik might file an administrative challenge to the charge through the Comptroller of the Currency. See id.

D.

In general, card issuers side with the cardholder in cases of doubt because the cardholders are their customers. Merchants realistically cannot stop taking their cards, while cardholders easily can switch to other card issuers. In addition, merchants generally have more money. In this case, however, Chase appears to have sided with the merchant, despite apparent doubt over whether the charges were authorized.

PROBLEM VII.

The edited excerpt in this case comes from LaBarge Pipe & Steel Co. v. First Bank, 550 F.3d 442 (5th Cir. 2008).



A.

PVF could not send a cashier's check or funds transfer unless it had $143,613.40 in its account to pay the bank for the check or funds transfer. The letter of credit allowed PVF to buy the pipes on credit, with payment to be made at a later time.

But there was a trade off. PVF would have had to compensate the bank for extending credit through the letter of credit. The bank might have charged something like 1% of the transaction, or $1436, compared to about $30 for a cashier's check or funds transfer.

B.

It was a stand-by letter of credit because the thought was that it would only be used if PVF defaulted on its obligations to LaBarge. See Textbook at 394.

A commercial letter of credit could have been used. The documentary presentation would require presentation of documents showing that the goods had been shipped (such as a bill of lading and an inspection certificate). See id.

C.

First Bank will argue that it did not have to pay LaBarge because LaBarge's "documentary presentation" did not "strictly comply" with the terms of the letter of credit. § 5-108(a). First Bank would point out that the letter of credit required the actual letter of credit to be presented, not a facsimile. Whether a facsimile is sufficient when a letter of credit calls for an original depends on the "standard practice" of issuers. Id. The parties should use expert testimony and documents such as those prepare by the international chamber of commerce to prove the standard practice of issuers. § 5-108(a).

D.

LaBarge might have a claim against PVF for breach of contract because it did not pay for the pipe. It can bring this claim even though it received the letter of credit. § 2-325.

PVF also might have a claim against First Bank for wrongful dishonor. § 5-111(b). But if First Bank pays LaBarge, First Bank would have a right to reimbursement from PVF. § 5-108(i)(1).

The George Washington
University Law School

December 13, 2007

Grading Guide

for the Final Examination in

COMMERCIAL PAPER--PAYMENT SYSTEMS

(Course No. 282-20; 3 credits)

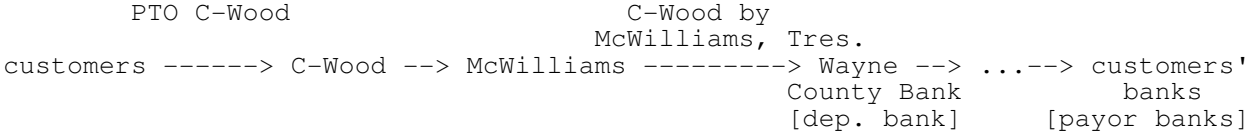
Professor Gregory E. Maggs

INTRODUCTION

I used this guide in grading all the examinations in this course. The explanations in this guide often are longer or more complete than what would was expected or necessary on an actual exam answer. The answers contain various "notes" and parenthetical phrases. Usually, they refer to issues that some students might see, but that went a little beyond the scope of the course. The examination instructions did not require drawing diagrams of the transactions at issue. The diagrams included here serve only to provide clarity. Incomplete answers or answers that contained some mistakes received partial credit.

PROBLEM I. **(26 points)**

The edited excerpt in this problem comes from C-Wood Lumber Co., Inc. v. Wayne County Bank, 2007 WL 187892 (Tenn. Ct. App.).



A. May the banks that paid the checks charge the drawers of those checks?

Yes. A bank may charge a customer's account for a check that is properly payable when it is authorized by the customer. 4-401(a). The customers who wrote checks authorized the payor banks to pay them to C-Wood. Because McWilliams appears to have had authority to bind C-Wood to a simply contract by reason of her position of Secretary/Treasurer, she could make an authorized indorsement of the checks. 3-402(a). Alternatively, even if she did not have authority to make the indorsements, the unauthorized indorsements are effective as the indorsements of C-Wood because she was employee of C-Wood entrusted with responsibility for the checks. 3-405(b)'s 1st sent. There are no facts suggesting that the banks payor failed to exercise ordinary care and would have to share the liability. 3-405(b)'s 2d sent.

B. What claims, if any, does C-Wood have against the drawers of the checks, Wayne County Bank, or the payor banks?

Against the drawers: C-Wood has no claim against the drawers of the checks. When C-Wood took the checks, any underlying claims that C-Wood had against the drawers were suspended. 3-310(b).

Against Wayne County Bank: C-Wood may claim a possessory and property interest in the checks based on McWilliams's breach of her fiduciary duty to the company. 3-306, 3-307 cmt. 2. Wayne County Bank is subject to this claim; although Wayne County Bank gave value for the checks, it is not a holder in due course because it had notice of the breach of the fiduciary duty when McWilliams put the checks in her own personal account. 3-307(b)(2). See Smith v. Olympic Bank.

Note: Some answers said that Wayne County Bank might be liable for negligence. Although we did not address this theory in class, some courts have accepted it. See, e.g., Crick v. HSBC Bank, 775 N.Y.S.2d 497 (N.Y. City Civ. Ct. 2004).

Against the payor banks: The payor banks, as the drawees, have no liability on the checks. 3-408.

C. What is Ms. McWilliams liability under U.C.C. article 3?

McWilliams is liable to C-Wood based on C-Wood's possessory claim to the proceeds from the checks discussed above. 3-306. McWilliams also may be liable for common law conversion, as incorporated by § 3-420(a), depending on how the pertinent jurisdiction defines this tort. See Casebook, pp. 289-292; 3-420(a)'s 1st sent. (incorporating the law of conversion in the U.C.C.); Black's Law Dictionary (generally defining conversion as the "wrongful possession or disposition of another's property as if it were one's own.").

McWilliams is liable to Wayne County Bank for breach of the transfer warranty that the instrument is not subject to a claim that may be asserted against her. 3-416(a)(4). The damages would equal whatever Wayne County Bank has to pay to C-Wood.

McWilliams does not appear to be liable to the drawers or payor banks. They have not suffered any loss. (She also was entitled to enforce the checks, given that her signatures was effective as described in part A, and therefore did not breach any presentment warranty.)

Note: Whether McWilliams faces liability outside of the U.C.C. is beyond the scope of this question.

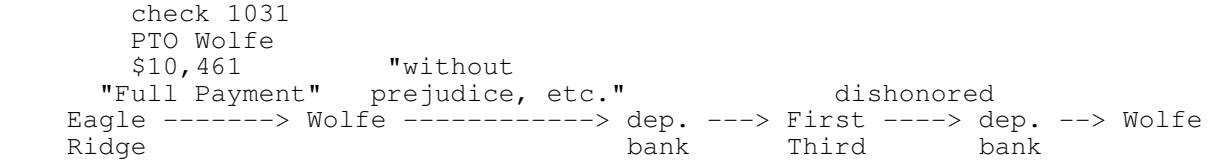
D. What steps should C-Wood have taken to protect itself?

C-Wood should have (1) been more careful in hiring McWilliams; (2) adopted "internal controls" that the opinion says were missing, such as having someone supervise or check her work; and perhaps (3) should have had an outside auditor examine the books to detect fraud.

PROBLEM II. (26 points)

The edited excerpt in this problem comes from Wolfe v. Eagle Ridge Holding Co., LLC., 869 N.E.2d 521 (Ind. Ct. App. 2007).

Wolfe claims Eagle Ridge owes $27,031.75 - $12,000 = $15,031.75
Eagle Ridge thinks it owes only $10,461.94



A. What rights does Wolfe have against Eagle Ridge and Fifth Third?

Against Eagle Ridge: Because the check 1031 was dishonored when presented, Wolfe has a choice: Wolfe may enforce either check 1031 or the underlying contract against Eagle Ridge. 3-310(b)(3). If Wolfe enforces the check and obtains payment, an accord and satisfaction will be formed, and Wolfe will receive only $10,461.64. 3-311. If Wolfe enforces the underlying contract, Wolfe could recover up to $15,031.75, depending on what the court thinks is still due under the contract.

Against Fifth Third. Fifth Third, as the drawee, has no liability on the check. 3-408.

B. If Wolfe asks Eagle Ridge to replace check 1031, what advice would you give Eagle Ridge?

Eagle Ridge has no duty to give Wolfe a replacement check. Even though check 1031 is now more than 6 months old and was dishonored, nothing in article 3 requires a drawer to issue a replacement check. (As noted above, however, Wolfe does have a claim against Eagle Ridge either on check 1031 or on the underlying contract obligation.)

If Eagle Ridge voluntarily gives Wolfe a replacement check, Eagle Ridge should demand that Wolfe return check 1031. Cf. Kaw Valley State Bank v. Riddle (failure to obtain return of original when replacement instrument issued.) Although it is unlikely that anyone could become a holder in due course of check 1031 now that it is overdue, defending a lawsuit brought on check 1031 still would be a hassle.

Eagle Ridge should place the same accord and satisfaction language on any replacement check because no accord and satisfaction has yet been formed given that Wolfe did not receive payment. 3-311

C. If Fifth Third had paid the check, what liabilities would the parties now have?

Fifth Third could charge Eagle Ridge's account even though the check was overdue. 4-401(a) (bank may charge a customer's account for a check that is properly payable); 4-404 (bank may charge a customer's account for a check that is more than 6 months old).

Wolfe could not recover from Eagle Ridge on the underlying obligation if the check was effective to create an accord and satisfaction. Under 3-311, an accord and satisfaction has four requirements: good faith, a bona fide dispute, a conspicuous statement, and obtaining payment. There was a conspicuous statement. If Fifth Third had paid the check, Wolfe would have obtained payment. Therefore, if Eagle Ridge acted in good faith and there was a bona fide dispute (the facts don't say), then it appears the elements of 3-311 would be met and there would be an accord and satisfaction.

The attempt by Wolfe to reserve rights would be ineffective to prevent an accord and satisfaction. 1-308(b).

D. How could the parties have used a standby letter of credit to reduce concerns about each other's performance of the contract?

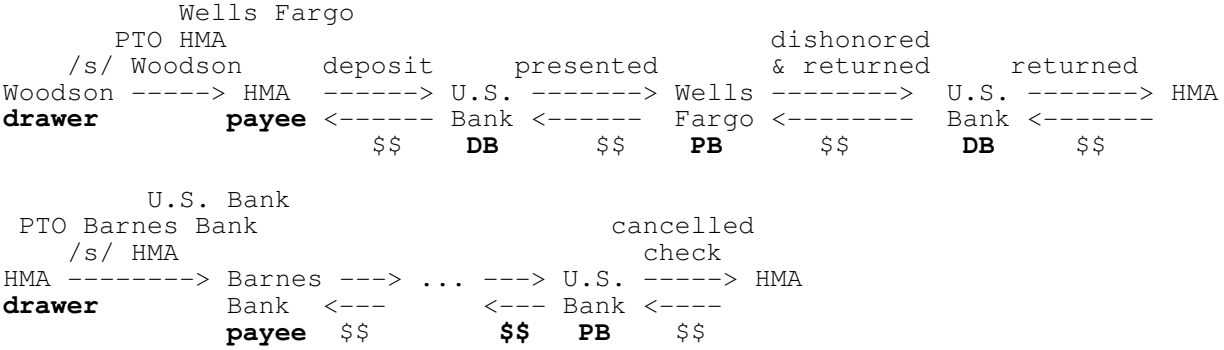
They could have specified in the letter of credit that the bank would pay specified sums of money when presented with a document signed by a trustworthy third party that the work or certain portions of the work were completed. See Casebook, p. 394. For example, they could have made payment turn on an affidavit by a qualified building inspector that 1/3, 2/3, and 3/3

of the work was complete, and that the same proportion of payment was due. This way, neither party would have to trust the judgment of the other party as to whether payment was due.

PROBLEM III. **(26 minutes)**

The edited excerpt in this problem comes from U.S. Bank Nat. Ass'n v. HMA, L.C., 2007 WL 1452649 (2007).

HMA deposited a check from Woodson and HMA then wrote a check to Barnes Bank:



A. What information would the court need in order to decide whether the midnight deadline was Saturday or Monday, and why might the decision matter?

A "banking day" is defined as "the part of a day on which a bank is open to the public for carrying on substantially all of its banking functions. 4-103(a)(3); Oak Brook Bank v. Northern Trust. So to decide the question, the court would have to determine whether Wells Fargo was open on Saturday for substantially all of its banking functions. The decision matters because if Wells Fargo missed its midnight deadline, it is accountable for the check. 4-301(a)(1).

B. Under what circumstance would U.S. Bank be a holder in due course of the Woodson check and why might being a holder in due course matter?

U.S. Bank would be a holder in due course of the Woodson check if it took the check in good faith, for value, and without notice of defects. 4-205. The facts do not suggest that U.S. Bank acted in bad faith or had notice. U.S. Bank gave value to the extent that it acquired a security interest in the check, 4-211, and it acquired a security interest in the check to the extent that it allowed HMA to withdraw credit that it gave for the check, 4-210(a)(1).

If U.S. Bank cannot obtain a refund of all of the credit for the Woodson check from HMA, it may enforce the check against Woodson, the drawer. 3-414(a). Woodson stopped payment on the check, suggesting that Woodson may have a defense to payment. If U.S. Bank is a holder in due course, Woodson could not assert any ordinary defenses against U.S. Bank. 3-305(b).

C. What liability, if any, might Barnes Bank face?

U.S. Bank mistakenly paid the check that HMA issued to Barnes Bank thinking that the account had enough money. U.S. Bank may seek to recover this money from Barnes Bank under a theory of restitution. 3-418(b) & cmt. 3. But under the Price v. Neal exception, U.S. Bank could not recover the money

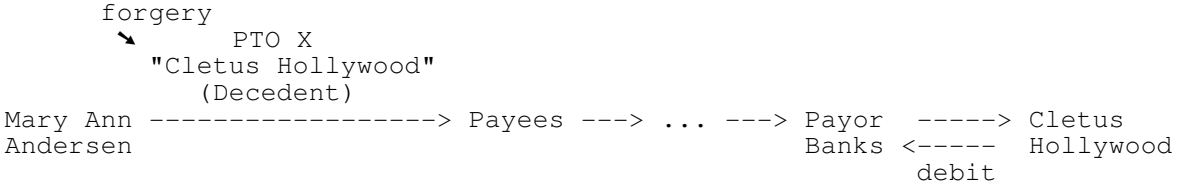
if U.S. Bank took the check in good faith and for value or if it relied on the check. 3-418(c). The problem does not indicate whether that happened or not.

D. Why might U.S. Bank have paid the check that HMA wrote to Barnes Bank without knowing for sure whether the Woodson check would be paid?

Because U.S. Bank had given HMA credit for the Woodson check, it had to honor the check that HMA issued to Barnes Bank or face liability to HMA for wrongful dishonor. 4-402.

At least ffour factors may have influenced U.S. Bank's decision to give HMA credit for the Woodson check. First, Reg. CC may have required U.S. Bank to give credit for some or all of the check if it was a local check. Second, U.S. Bank might have given credit (as many banks do) as a matter of good customer relations even if Reg. CC did not require it to give credit. Third, U.S. Bank had no way of knowing for sure when it would learn of the dishonor of the Woodson check, because it did know how many intermediary banks would handle the check, how many bank days would be involved, or whether there would be any excusable delay. Fourth, U.S. Bank might have known that it could become the holder in due course of the Woodson check if it gave credit for the check and thus it may have worried less about giving credit. See Casebook, p. 68.

PROBLEM IV. **(26 points)**



The edited excerpt in this problem comes from Hollywood v. First Nat. Bank of Palmerton, 859 A.2d 472 (Pa. Super. 2004).

A. What claims might the Estate bring against the Banks and how should they be resolved?

The Estate may claim the Banks must re-credit the Decedent's account for the amounts of any checks written by Mary Ann. Ordinarily, a bank can charge a customer's account only for a check that was properly payable. 4-401(a). The Estate will argue that the checks were not properly payable because Mary Ann's signature was unauthorized. The Banks may respond that, even if Mary Ann's signature was in fact unauthorized, the estate is precluded from asserting that it was unauthorized for two reasons. First, the Decedent's negligence substantially contributed to the making of the forgery because he allowed Mary Ann to have access to his checkbooks. 3-406(a). Second, there has been considerable delay in reporting the unauthorized signatures on multiple checks by the same wrongdoer. 4-406(d)(2).

The Estate also may seek rescission of any check transactions on grounds that the Decedent's "worsening" mental status meant that he lacked mental capacity. 3-202(b). Lack of capacity is a real defense that may be asserted even if the checks passed through the hands of a holder in due course. 3-305(a).

B. Could the Estate recover from the payees of the checks under a theory of conversion or any other theory?

If the checks are not properly payable from the Decedent's account (see above), then the Estate has not suffered any injury and cannot recover from the payees under a theory of conversion or any other theory. See 3-420 cmt. 1, ¶3.

If the checks are properly payable -- for example, if the Estate is precluded from denying that the checks were authorized under 3-406 or 4-406, as discussed above -- then the Estate would have no claim for conversion because (1) the Decedent would be deemed to be the issuer of the checks and (2) the issuer of a check cannot bring a claim for conversion. 3-420(a)'s last sentence. But the Estate might be able to recover from the payees under a theory of restitution, especially if the payees did not give value for the checks or did not rely on payment of the checks (for example, if Mary Ann Andersen had given the checks to friends as gifts). This liability for restitution comes from principles of equity rather than U.C.C. article 3.

C. What is Mary Ann Anderson's liability under article 3?

If the banks cannot charge the Decedent's accounts for the checks, the banks can enforce them against their true "drawer," namely, Mary Ann Andersen. 3-301; 3-401(a).

D. If James [Hollywood] had wanted to prevent this fraud from occurring, what legal and practical difficulties might he have faced?

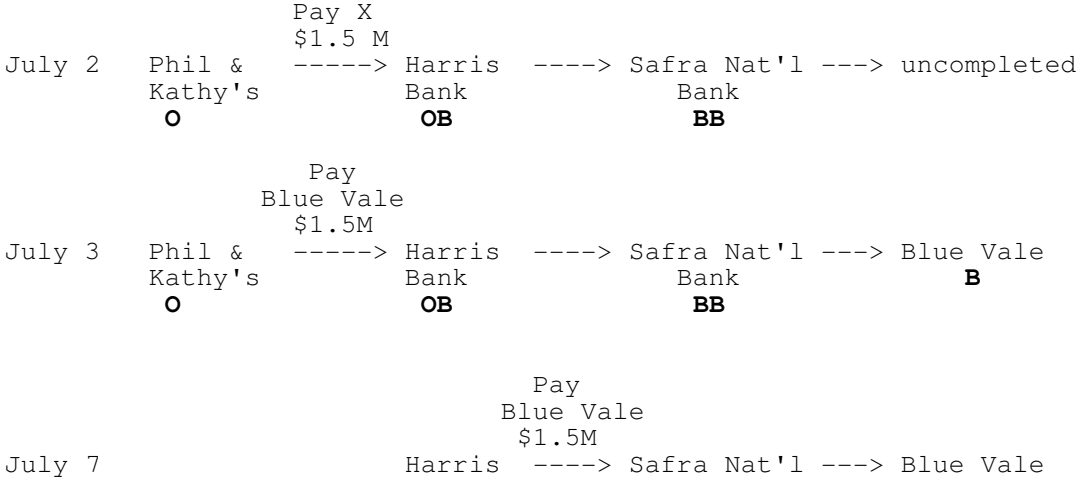
James might have prevented some of this fraud by regularly examining his father's bank records. But prior to his father's death and his appointment as Administrator, James had no legal right to inspect his father's financial statements. Although he could have asked his father and perhaps his sister for permission, that solution seems impractical. They would have wanted to know why he wanted to examine the records, and he had no grounds for saying that he suspected that fraud might occur.

Perhaps James would have done better to take his father into his own home if he did not trust his sister.

PROBLEM V. **(26 points)**

The edited excerpt in this problem comes from Phil & Kathy's, Inc. v. Safra National Bank of New York, 2006 WL 3208587 (S.D.N.Y.).

The following events occurred in this problem:



amendment	Bank **OB**	Bank **BB**	**B**

A. Must Phil & Kathy's, Inc. pay Harris Bank for both payment orders?

Basic rules: The sender of a payment order becomes obliged to pay when the receiving bank accepts the payment order. 4A-402(c)'s 2d sentence. But the obligation to pay is excused "if the funds transfer is not completed by acceptance by the beneficiary's bank of a payment order instructing payment to the beneficiary of that sender's payment order." 4A-402(c)'s 4th sentence.

July 2 Payment Order: Harris Bank clearly accepted the July 2 payment order because it executed a payment order intended to carry out the payment order. 4A-209(a). But Phil & Kathy's Inc. will argue that their obligation to pay for the July 2 funds transfer was excused because no payment was made to a beneficiary identified in the payment order. True, Harris Bank amended its payment order accepting the July 2 payment order. Harris Bank may have had a right to amend its payment order under 4A-211(b) before Safra National Bank accepted it. But still no payment was made to a beneficiary designated by Phil & Kathy's payment order. [Note: The court was confused about this point in the actual case.]

July 3 Payment Order: Phil & Kathy's Inc. must pay for its July 3 payment order because it was accepted by Harris Bank, and payment was not excused because the funds transfer was completed.

B. Could Safra National Bank have accepted the first payment order even though it misstated the name of the beneficiary?

If the name in the payment order referred to a non-existent beneficiary, then Safra National Bank could not accept it. 4A-207(a); Corfan Banco v. Ocean Bank.

If the name in the payment order referred to an existing beneficiary and the account number in the payment order referred to a different existing beneficiary, and Safra Bank did not know that the name and number referred to different beneficiaries, then Safra National Bank could have accepted the payment order and credited the beneficiary identified by the account number. 4A-207(b).

C. May Phil & Kathy's, Inc. recover from Safra National Bank?

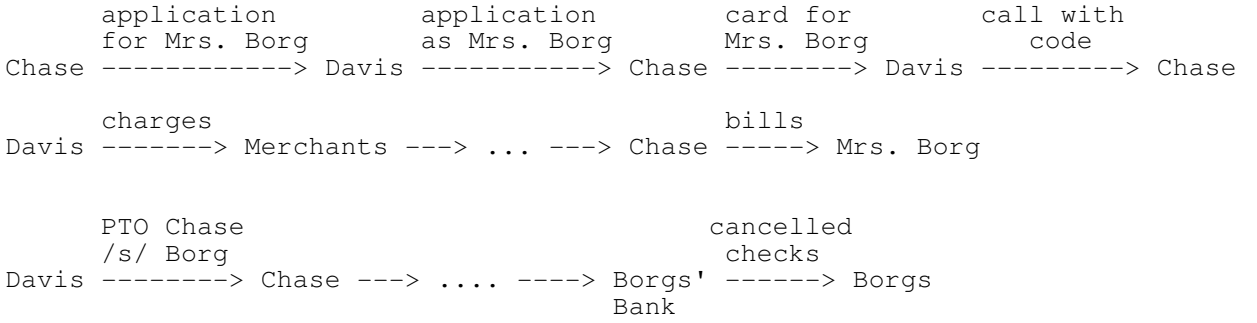
No. If Harris Bank had no right to charge Phil & Kathy's Inc. for the first payment order, then Phil & Kathy's Inc. cannot recover from Safra National Bank. They have not lost anything. If Harris Bank can charge them, that means that the payment order was properly accepted by Safra National Bank. If Phil & Kathy's Inc. want their money back, they must recover from Blue Vale. In addition, the originator generally only may recover from the originator's bank and not a bank involved later in the funds transfer. See Grain Traders v. Citibank.

D. What should Phil & Kathy's, Inc. have done after learning that the first payment order misidentified the beneficiary?

Here are two suggestions: First, Phil & Kathy's could have asked Harris Bank to cancel the July 2 payment order and make a refund to them under the money back guarantee. Whether Phil & Kathy's had a right to cancel or not, 4A-211(c), an attempt to cancel would have made clear to Harris Bank that it should not attempt to correct the first payment order. Second, Phil & Kathy's could have held back in sending the second payment order until they were sure that Harris Bank would not keep trying to send the first one.

PROBLEM VI.

The edited excerpt in this problem comes from Borg v. Chase Manhattan Bank U.S.A., 2007 WL 2088692 (2007).



A. Do Mrs. Borg and Chase have any claims against each other?

Chase's claim against Mrs. Borg: Chase will seek to recover for any credit card charges for which Davis has not yet paid. But Mrs. Borg will make two responses. First, she never accepted the credit card and therefore has no liability. 15 U.S.C. § 1643(a)(1)(A). Second, even if she had accepted the credit card (which she did not), the charges were unauthorized, and therefore her maximum liability cannot exceed $50. Id. § 1643(a)(1)(B). Chase might reply that, in Minskoff v. American Express, the Court held that a long-term failure to examine credit card statements precluded the cardholder from asserting that certain charges were unauthorized. But Mrs. Borg may argue that this case is distinguishable because she did not apply for any card and had no way of knowing that she was receiving bank statements.

Mrs. Borg's claim against Chase: Mrs. Borg will seek to recover payments made to Chase if she cannot recover those payments from the bank at which she has her checking account (see below). See Minskoff v. American Express (cardholder brought lawsuit to recover payments believed to be unauthorized). Whether she prevails will depend on the success of her arguments above.

B. What claims might the bank at which Mrs. Borg has her checking account assert against Mrs. Borg, Davis, and Chase?

Against Mrs. Borg: The bank has attempted to charge Mrs. Borg's checking account for the checks forged by Davis. Mrs. Borg will argue that the checks are not properly payable because Davis forged her signature as the drawer. 4-401. But the bank may assert that Mrs. Borg is precluded from asserting the forgery because her negligence in failing to supervise Davis substantially contributed to the forgery, 3-406(a), or because she delayed unreasonably in reporting a series of forgeries which were committed by the same wrongdoer, 4-406(d)(2).

Against Davis: If the bank cannot charge Mrs. Borg's account for the checks, then it could enforce them against Davis as the drawer. 3-403(a) (unauthorized signature effective as the signature of the authorized signer). But Davis probably does not have any money.

Against Chase: The bank cannot recover from Chase. Chase did not breach a presentment warranty because it had no knowledge that the drawer's signature was forged. 4-208(a)(4). Chase is probably not liable in restitution, even though payments were mistaken, because he took the checks in good faith and for value. 3-418(b),(c).

C. Does Mrs. Borg have any claim against Davis for restitution or conversion?

Restitution: Mrs. Borg has a claim for restitution against Davis to the extent she cannot recover the money from the bank at which she has her checking account. If Mrs. Borg can recover from the bank, then Davis has not been unjustly enriched at Mrs. Borg's expense.

Conversion: Mrs. Borg cannot recover for conversion under 3-420(a). Davis did not take an instrument from Mrs. Borg. Instead, she forged an instrument in Mrs. Borg's name.

D. What advice would you give Chase for recovering its losses in this cases and avoiding future losses?

If Chase can recover from Mrs. Borg for the charges (as discussed in part A), then Chase arguably does not need any additional advice.

If Chase cannot recover from Mrs. Borg, Chase might seek to recover from either Davis or the merchants. Davis is liable because she authorized the charges and committed the fraud. Private contracts used in the credit card system generally allow the issuing bank to "charge bank" unauthorized charges to the merchant. See casebook at 171.

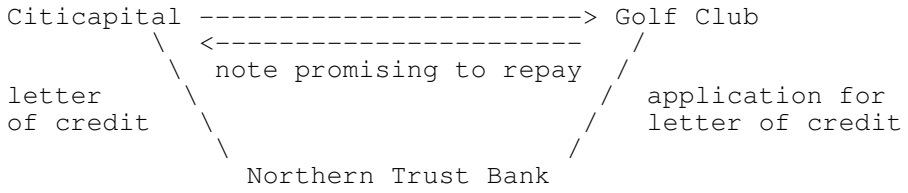
In addition, Chase should consider whether it could implement a better security system. For example, maybe Chase should require new cardholders to present an identification card to pick up new cards at a local bank rather than simply sending the new cards in the mail. Or it might restrict the initial credit limit on charges for a substantial period so that fraud can be detected. But of course from a business standpoint, any security procedure chosen should not cost more than the losses from unauthorized charges.

PROBLEM VII.

The edited excerpt in this problem comes from Morgan Creek Residential v. Kemp, 63 Cal.Rptr.3d 232 (Cal. App. 2007).

This problem involves both a note and a letter of credit, which I depict as follows:

Note: We promise to pay Citicapital $X.
/s/ Golf Club /s/ Morgan Creek Residential, for accommodation
/s/ Earl Kemp, for accommodation
/s/ Richard Haws, for accommodation



A. What claims might Morgan Creek Residential assert?

Morgan Creek Residential may claim a right to complete reimbursement from Golf Club. An accommodation co-maker who pays a note has a right of reimbursement from the accommodated co-maker. 3-419(f).

Morgan Creek Residential may claim a right to contribution from Kemp and Haws. A co-maker who pays a note has a right to contribution from any other co-makers who signed in the same capacity. 3-116(b). The right of contribution would allow Morgan Creek Residential to recover up to 1/3 of the amount of the note from each of them. See Syllabus Appendix 8 (notes on contribution).

True, Morgan Creek Residential did not "pay the note" directly to Citicapital. Instead, Northern Trust Bank paid Citicapital on the letter of credit, and Morgan Creek Residential reimbursed Northern Trust Bank. But this should be deemed a payment by Morgan Creek Residential to Citicapital. See 5-117(b).

B. Why might Citicapital have insisted on the letter of credit?

Citicapital probably was unsure about whether Golf Club, Morgan Creek, Earl Kemp, and Richard Haws could pay the note. It also did not want to bring a lawsuit against them if they did not pay. Instead, it felt more secure that the Northern Trust Bank could and would pay without any hassle. See Casebook at 394.

C. If you had been representing Citicapital in this transaction, what wording would you have proposed for the letter of credit?

In a letter of credit, the bank undertakes to pay money upon a documentary presentation. 5-102(a)(10). The letter of credit must identify the documents that are to be presented; it cannot make payment turn on "the actual existence in fact" of particular conditions. Wichita Eagle v. Pacific Nat'l Bank. Examples of language used by letters of credit appear in Syllabus Appendix No. 11. Based on these considerations, I would have proposed language such as:

> "Northern Trust Bank will honor Citicapital's drafts up to $1.4 million upon presentation of a signed statement by an authorized representative of Citicapital that the note of [specify date and other identifying characteristics] is in default and the default has not been cured."

D. If Northern Bank Trust had refused to pay the letter of credit even though Citicapital made a conforming documentary presentation, what rights would Citicapital have?

Citicapital could recover from Northern Trust Bank for wrongful dishonor. Its recovery would include the amount of the letter of credit, incidental damages, reasonable attorney's fees, and the expenses of litigation, but not consequential damages. 5-111(a),(e).

Citicapital also could enforce the note against any of the co-makers, all of whom would be jointly and severally liable on the note. 3-116(a). The issuance of the letter of credit did not affect the co-makers liability on the note because of the independence principle. 5-103(d).

The George Washington
University Law School

December 14, 2006

Grading Guide

for the Final Examination in

COMMERCIAL PAPER--PAYMENT SYSTEMS

(Course No. 282-20; 3 credits)

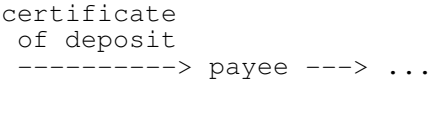
Professor Gregory E. Maggs

INTRODUCTION

I used this guide in grading all the examinations in this course. The explanations in this guide here often are longer or more complete than what would was expected or necessary on an actual exam answer. The answers contain various "notes" and parenthetical phrases. Usually, they refer to issues that some students might see, but that went a little beyond the scope of the course. The examination instructions did not require drawing diagrams of the transactions at issue. The diagrams included here serve only to provide clarity. Incomplete answers or answers that contained some mistakes received partial credit.

PROBLEM I. **(26 points)**

The edited excerpt in this case comes from Griffith v. Mellon Bank, N.A., 173 Fed. Appx. 131 (3rd Cir. 2006).



A. Mellon presented no evidence for its defense, but argued that the court should presume payment given the passage of time. What arguments might Griffith make for why the court should presume the instrument had not been paid?

Griffith should argue that if Mellon Bank had paid the certificate of deposit, it would have had a right either (1) to require the holder to surrender the certificate of deposit or (2) to mark the certificate of deposit as paid. 3-502(b)(2). Mellon Bank ordinarily would have exercised these rights because, otherwise, Mellon Bank would have run a risk that the certificate of deposit would be negotiated to a holder in due course who could demand that Mellon Bank pay the instrument again. But the certificate of deposit in this case was neither surrendered nor marked as paid. For these reasons, the court should presume that Mellon Bank had not paid the instrument.

In addition, Griffin could argue that nothing in article 3 creates a presumption of payment. On the contrary, the statute of limitations provision, § 3-119(c), establishes what effect the passage of time should have. This section does not create a presumption of payment, but instead says that a claim becomes unenforceable six years after a demand for payment.

Finally, Griffith could argue that Mellon Bank surely would have kept a record of paying the instrument, if it in fact had paid the instrument, even

after the passage of 25 years. Lengthy record keeping is required for CDs because the period of limitations does not begin to run until a demand for payment is made. And the CD was also for a large amount of money.

B. If Griffith sues to enforce the note, who has the burden of proof on the issue of whether the certificate of deposit has been paid and how might this burden be met?

The plaintiff seeking to enforce a negotiable instrument has the burden of proving an entitlement to force, and the defendant has the burden of proving defenses. 3-308(b). Mellon Bank therefore has the burden of proving the defense that the instrument has been paid. Mellon Bank could meet this burden in a variety ways. For example, it might have a witness testify, based on actual knowledge or business records, that Mellon paid the instrument.

Note: In the actual case, Mellon had no proof but argued that the common law created a presumption that any debt over 20 years old had been paid.

C. Under what circumstances, if any, could Mellon be liable on the certificate of deposit to Griffith even if evidence shows that Mellon Bank already had paid it?

Even if Mellon Bank has a defense (i.e., that the note has been paid, 3-602(a)), Mellon Bank would be liable to Griffith if Griffith were a holder in due course or if he had the rights of a holder in due course. 3-305(b). Griffith does not appear to be a holder in due course because he had notice that the certificate of deposit was overdue because the maturity date had passed. 3-302(a)(2)(iii); 3-304(b)(2). But it is possible that Griffith could have acquired the rights of a holder in due course under the shelter doctrine if a previous owner of the certificate of deposit was a holder in due course. 3-302(b). For example, a previous owner of the certificate of deposit may have been a holder in due course if he or she took the certificate of deposit in good faith and for value and without notice of its being paid or overdue prior to 1975. If this previous owner indorsed the instrument in blank (or if the instrument was payable to bearer), Griffith's acquisition of possession of the instrument would have been a negotiation transferring to him the rights of the previous holder. 3-201(a).

Note: If Mellon Bank had handed over money to someone not entitled to enforce the instrument, it would not have a defense. 3-602(a). But that is not really "paying" the instrument, as asked in the question.

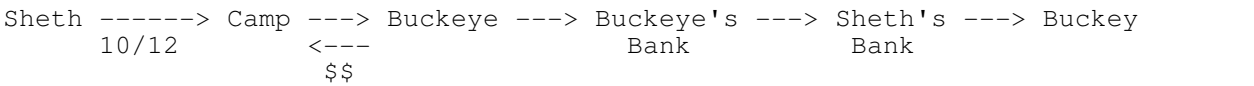
D. Would the statute of limitations in § 3-118(e) provide a defense if Griffith filed suit in 2001?

The statute of limitations in 3-118(e) would provide a defense only if Mellon Bank could show that a demand for payment had been made six years before the lawsuit (regardless of whether Mellon actually paid the certificate deposit). 3-118(e). If Griffith was the first person to demand payment when he presented the instrument in January of 2001, then the statute of limitations would not have run if he also filed suit in 2001. If someone else demanded payment more than six years before 2001, then the statute of limitations would have run.

PROBLEM II. **(26 points)**

The edited excerpt in the case comes from Buckeye Check Cashing, Inc. v. Camp, 825 N.E.2d 644 (Ohio App. 2005).

PTO Camp
/s/ Sheth dishonored



A. Sheth argued that by not "taking any steps to discover whether the postdated check issued by Sheth was valid, Buckeye failed to act in a commercially reasonable manner."

1. Why might it matter whether Buckeye acted in a commercially reasonable manner?

Now that the check has been dishonored, Buckeye may wish to enforce the check against Sheth. 3-414(b). Sheth has an ordinary contract law defense to payment (i.e., Camp did not perform). 3-305(a)(2). This defense would not be applicable to a holder in due course, 3-305(b). Buckeye will have the status of a holder in due course only if, among other things, Buckeye acted in good faith. 3-302(b)(2)(ii). And Buckeye acted in good faith only if it observed "reasonable commercial standards of fair dealing." 1-201(b)(20).

2. How might Buckeye respond to Sheth's argument?

As noted above, good faith requires observance of "reasonable commercial standards of fair dealing." 1-201(b)(20). Buckeye should argue that it would not be "reasonable" to expect a check cashing service to take "steps to discover" the validity of checks that it is considering purchasing because these steps would be too expensive and time consuming. Indeed, the principal purpose of the holder in due course doctrine is to encourage the circulation of negotiable instruments by making it unnecessary for the purchaser of an instrument to inquire into its validity. See Casebook, p. 3.

Sheth might counter that the court Maine Family Federal Credit Union v. Sun Life held that a depositary bank act did not act in good faith when it gave credit for a check without placing a hold on uncollected funds for a reasonable time. By analogy, Sheth might say that Buckeye should not have given Camp immediate cash for the check. But Buckeye could respond that Maine Family Federal Credit Union's holding is incorrect according to learned commentators. See Casebook, p. 43.

B. If Camp had indorsed the check without recourse, to what extent would he have avoided liability?

Ordinarily, an indorser has an obligation to pay the check if the check is dishonored, as it was here. 3-415(a). But Camp would have avoided this liability by indorsing the check "without recourse." 3-416(b).

Anyone would transfers a check for consideration warrants that the instrument is not subject to defenses. 3-416(a)(4). Camp would not avoid this liability by indorsing the check without recourse because this form of liability cannot be disclaimed with respect to checks. 3-416(c).

If Camp committed fraud (as the facts suggest), Buckeye could sue to rescind the negotiation of the check. 3-202(b). Outside of the U.C.C., Camp still would be liable to Sheth for breach of contract for failing to perform the services that he promised. Camp also might be liable for fraud under tort law.

C. What advice would you give Sheth for future transactions?

Sheth should be careful not to issue a negotiable instrument in situations in which he might have a defense to payment (such as non-performance) because he would be unable to assert the defense if the instrument ended up in the hands of a holder in due course (like Buckeye). He

also should realize that stopping payment on a check does not end his liability on the check; on the contrary, he becomes liable on the check precisely when the check is dishonored. 3-414(b).

Sheth could avoid problems in future transactions in several ways: (1) He could refuse to pay until performance is complete. (2) He could pay with a non-negotiable instrument, such as a note marked "not negotiable," to which the holder in due course does not apply. 3-104(c). (3) He could pay with a credit card so that he could assert defenses against the issuer. 15 U.S.C. § 1666i. (4) He could pay with a letter of credit, requiring the beneficiary to produce documentary evidence that he or she had performed.

Note: Checks, as opposed to notes, cannot be made non-negotiable. 3-104(c).

PROBLEM III. **(26 points)**

The edited excerpt in this case comes from NBT Bank, Nat. Ass'n v. First Nat. Community Bank, 393 F.3d 404 (3d Cir. 2004)

Drawer ---> Payee ---> NBT Bank ---> FRB ---> FNCB

A. After the Disputed Check was presented, what actions did FNCB have to take to avoid being accountable or otherwise liable for the check?

To avoid liability, FNCB had to take the following actions: (1) send notice that it was dishonoring the check by 4:00 p.m. on the second business day following the banking day on which the check was presented (because the check was for $2500 or more), Reg. CC 229.33(a); (2) return the check by its midnight deadline, 4-302(a)(1); and (3) return the check in an expedited manner under either the "two-day/four day test" or the forward collection test, Reg. CC § 339.30(a). FNCB attempted to use the forward collection test by encoding the check as a qualified returned check. Id. § 339.30(a)(2).

B. Does it matter whether the "Disputed Check was physically delivered to the Reserve Bank prior to the midnight deadline" as the parties have agreed?

No. The midnight deadline is satisfied when the check is returned (i.e., sent), not when it is delivered. 4-301(a)(1); Blake v. Woodford Bank. Regulation CC imposes requirements on the method of return, but none of these requirements specifically turn on whether the check is or is not returned by the midnight deadline. Reg. CC, § 229. 30(a) (ordinary expeditious return requirement); § 229.30(c) (extension of midnight deadline).

C. Why might the encoding error on the Disputed Check not have caused NBT to suffer a loss?

NBT clearly has suffered a loss because it is making a claim for the the amount of the check. But the encoding error might not have caused NBT to suffer this loss for several reasons. First, the encoding error may not have caused a delay if the Federal Reserve Bank immediately noticed and dealt with the error. Second, even if the encoding error caused a delay, NBT already may have allowed the depositor to withdraw funds given for the check. In that case, further delay would not matter. Third, NBT may already had received notice of dishonor under Reg. CC 229.33(a). In that case, delay in the actual return of the check might not matter; NBT could have acted immediately on the notice.

Note: NBT also would not have suffered a loss if it had not allowed the check kiter to withdraw any of the funds. But that possibility must be ruled

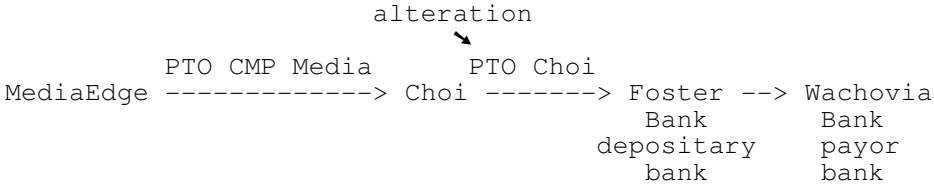
out given that NBT is making a claim for the face value of the check. If the check kiter had not withdrawn the funds, NBT would have no reason to make a claim.

D. How might the Check 21 Act reduce the risk of loss from check kiting schemes?

Check kiting schemes take advantage of period between the time of depositing a check and the time of presentment, dishonor, and return of the check. Sometimes the depositary bank grants the depositor provisional credit during this time lag. A check kiter may deposit checks with the intent of removing this provisional credit and absconding before the depositary bank learns that the check has been dishonored and attempts to revoke the provisional credit. See, e.g., Oak Brook Bank v. Northern Trust. The Check 21 Act may reduce the risk of loss from check kiting schemes by facilitating electronic presentment of checks. The faster the checks are presented, the earlier they can be returned if they are dishonored. So the depositary bank will learn sooner of the check's dishonor, and can refuse to grant credit or can revoke it before the check kiter absconds with the money.

PROBLEM IV. (26 points)

The edited excerpt in this problem comes from Wachovia Bank, N.A. v. Foster Bancshares, Inc., 457 F.3d 619 (7th Cir. 2006).



A. Exactly how might Choi have committed this fraud by forging a check as opposed to altering the original check?

Altering the original check might have involved erasing the payee's name on the original check and substituting her own name.

Forging a check would involve making a new check on a new piece of paper. Choi, for example, may have scanned the original check into a computer, changed the name of the payee, and then printed the new check on a new piece of paper, and forged the drawer's signature.

Apart from the new payee, the forged check would have appeared to have all of the same information (check number, amount, signature, date, etc.). Simply finding another blank check and filling it out might not have worked because the check would have a different number and the signatures would not be exactly the same.

Note: This problem requires knowing that a "forged check" is a check with an unauthorized drawer's signature, not an unauthorized indorsement. *See* § 3-406 cmt. 3.

B. If Choi had stolen the original check and then altered it, what rights would MediaEdge and CMP Media have against Choi?

They would have no rights against her (or at least not under article 3). Sometimes a thief who steals a negotiable instrument is liable for conversion. See 3-420(a). But the issuer of a check and a payee who did not receive

delivery of a check cannot bring an action for conversion. See 3-420(a)(i)&(ii).

This result makes sense because neither of them has suffered a loss. 3-420 cmt. 1. MediaEdge has not suffered a loss because Wachovia Bank cannot charge its account for the check; whether the check was forged or altered, it is unauthorized. 4-401(a). CMP Media has not suffered a loss because its underlying right to payment from MediaEdge has not been discharged because it did not receive the check. 3-310(b).

C. Why might it matter whether the check was a forged check as opposed to an original check with an alteration?

Foster Bank, the depositary bank, would bear the liability for a check with an alteration because it warranted that the check was not altered. 4-208(a)(2). But Wachovia Bank, as the drawee, would bear liability for a forged check because Foster Bank in presenting the check warranted only that it had no knowledge that the drawer's signature was forged. 4-208(a)(3).

Wachovia Bank cannot charge MediaEdge's account regardless of whether the check is altered or forged, 4-401(a), unless some exception to the properly payable rule applies. And Wachovia Bank could recover from Choi regardless whether the check was forged or altered.

D. Unable to decide whether the check was forged or altered, the court said: "So the case comes down to whether, in cases of doubt, forgery should be assumed or alteration should be assumed." What policy arguments might support presuming that the check was altered?

One school of thought is that loss should fall on the person best able to take action to avoid the loss. Ordinarily, the payor bank is thought to be the best able to determine whether a check has been forged because, at least theoretically, the payor bank can compare the drawer's signature on the check to its customer's signature which it has on file. And the depositary bank is thought to be the best able to avoid loss caused by a forged indorsement because it is closer to the chain of possession to the culprit. The depositary bank, for example, has the opportunity to know the persons who deposit altered checks because they are the depositary bank's customers. That's why the loss from forged checks ordinarily fall on the payor bank and the loss from alterations fall on the depositary bank.

But this problem concerns a non-ordinary circumstance. It is about cases of doubt where no one can determine whether a check was forged or altered. In this situation, the payor bank has little advantage in avoiding loss. But the depositary bank is still closer to the culprit. So the loss should fall on the depositary bank and an alteration should be presumed.

PROBLEM V. (26 points)

This edited Excerpt comes from Zengen, Inc. v. Comerica Bank, 40 Cal. Rptr.3d 666 (Cal. App. 2006), review granted, 140 P.3d 656 (Cal. 2006).

A. If Zengen and Comerica had agreed that Comerica would accept faxed payment orders "purportedly signed and authorized by Johnson Liu," could Comerica charge Zengen's account?

As the originator's bank, Comerica can charge Zengen only if the payment orders were authorized, 4A-202(a), or if they were effective because they have been verified by passing a commercially reasonable security procedure, 4A-202(b).

The payment orders were not verified by a commercially reasonable security procedure. Even if the parties agreed that Comerica would pay orders purportedly signed by Johnson Liu, that security procedure is not commercially reasonable. A signature alone cannot be a security procedure. 4A-201's last sentence.

Whether the payment orders were authorized is a more complicated question. On one hand, they complied with the parties' agreement, and thus would seem to be authorized. 4A-203 cmt. 1 (specifying that an agreement can determine when payment orders are authorized). But on the other hand, if a signature alone cannot serve as a security procedure, then arguably the parties should not be able to agree that a false signature is authorization.

B. Zengen claimed that Comerica was negligent in "failing to call Zengen to verify the authority to issue the Payment Orders." How should Comerica respond to this claim?

Comerica should respond in two ways. First, it should assert its negligence is irrelevant because article 4A does not create a cause of action for negligence and because article 4A preempts common law negligence actions. 4A-102 cmt. 1; Citibank v. Grain Traders, etc. Second, it should contend that it was not negligent because it had no duty to call Zengen. A bank does not have to use any security procedure unless the parties have agreed to that procedure. 4A-201; 4A-202(b).

C. May Zengen or Comerica Bank recover from Chinatrust Bank in restitution?

Probably not. Restitution allows a party to recover for unjust enrichment. Here, although Chinatrust received the money, Chinatrust has not been unjustly enriched because all of the money has been withdrawn. [See funds transfer problem, pp. 221-222]

Article 4A does not provide for recovery in restitution from the beneficiary's bank, and presumably preempts common law/equitable restitution causes of action. 4-102 cmt.

D. How might the liability be different if, instead of sending fraudulent funds transfers, Fung Yen had forged checks drawn on Zengen's account at Comerica Bank, deposited the checks in Chinatrust Bank, and then withdrawn the money?

Chinatrust would still not have liability because the loss falls on the payor bank in cases of forged instruments. Price v. Neal.

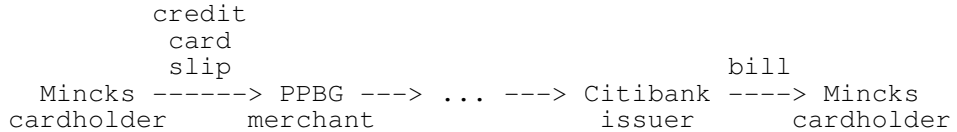
Comerica could not charge Zengen's account for the checks, 4-401(a), unless an exception to the properly payable rule applied. In particular, Zengen would bear liability for (1) any checks if its negligence substantially contributed to the making of the forged drawer's signature, 3-406(a), and (2) any checks paid after Zengen has a reasonable time to examine its account statement, 4-406(d)(2). Both of the exceptions appear possible on these facts.

Fung Yen would be liable for the checks, but he would also be liable for the unauthorized funds transfers.

Note: Section 3-405(b) does not apply because the check does not involve a forged indorsement.

PROBLEM VI. **(25 points)**

The edited excerpt in this problem comes from Citibank (South Dakota), N.A. v. Mincks, 135 S.W.3d 545 (Mo. App. 2004).



A. Did the failure to notify Citibank within 60 days of the charge bar the claim against Citibank?

No. Under 15 U.S.C. § 1666i, a cardholder may assert against the issuer claims and defenses that the cardholder has against the merchant arising out of a charge. Nothing in this provision requires the cardholder to assert the claim within 60 days.

Note: The facts do not suggest that Citibank attempted to limit this period by contract. If Citibank had attempted to impose a 60 day limit, a court would have to determine whether the statute made such limits unenforceable. Arguably, limits of this kind would undermine the protection that the statute seeks to provide consumers.

B. What other arguments might Citibank possibly have made in opposing the demand that it recredit the account?

Citibank would not have to recredit the account if the conditions in 15 U.S.C. § 1666i were not satisfied. One of these requirements is that the charge must be made within the same state or within 100 miles from the cardholder's home. If the Mincks live in Missouri and the charge was made in Ohio (and the two locations are more than 100 miles away), Citibank could assert that the charge is not covered. State contract law would determine where the contract was formed (i.e. in Missouri or Ohio). As discussed in connection with Izraelewitz v. MHT, the traditional rule is that the contract is formed where the acceptance is uttered. Some card issuers waive this requirement by agreement, allowing their customers to assert defenses regardless of where the transaction occurred. (Note: In the case of an order for goods, the order is presumed to be an offer which the seller accepts. U.C.C. 2-206(2)).

Citibank also might argue that the Consumer Credit Protection Act should not apply to this transaction because it is a business transaction. (In the actual case, Citibank made this argument, but the court rejected it because the court concluded that the section applies to any transaction made on a consumer credit card.)

C. If Citibank must recredit the account, who will bear the loss in this case?

Card issuers generally have a right to "chargeback" to the merchant any disputed charges. [See casebook p. 188]. But in this case, PPBG appears to

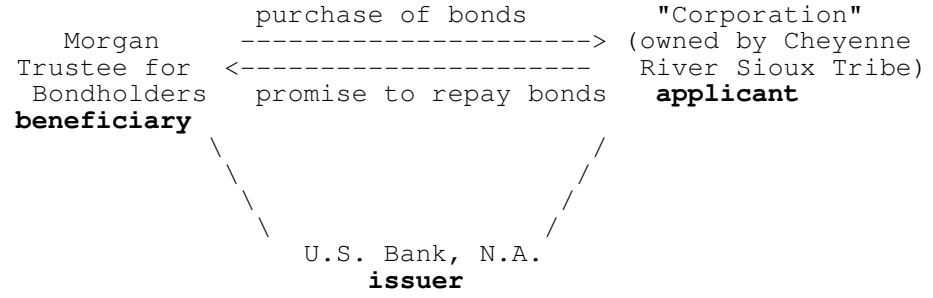
have gone out of business. So either Citibank or the PPBG's bank will bear the loss. The Minckses will not bear the loss.

D. If Citibank had not authorized Chuck Mincks to use the credit card, would the liability of the parties be different?

It would not affect the liability of Mary Mincks. She is liable for her own charges and for charges made by people whom she has authorized to use her card. Although Citibank might object to Mary Mincks's authorizing her husband to use her card, she would still be liable for any charges that he made (unless she could assert a defense against the issuer under 15 U.S.C. § 1666i). 15 U.S.C. § 1602(o); Minskoff v. Citibank (discussing authority).

PROBLEM VII. (25 points)

The edited excerpt in this problem comes from J.P. Morgan Trust Co., N.A. v. U.S. Bank, N.A., 446 F. Supp.2d 956 (E.D. Wis. 2006).



A. What were the terms and conditions for payment of the letter of credit and why might the parties have chosen them?

The letter of credit said the Bank would pay upon presentation of documentary evidence either (1) that "the Corporation defaulted on its bond payments and that Morgan foreclosed on the herd and equipment" or (2) that "the Bank had declined to permit the letter to automatically renew." The parties may have insisted on the first term because it would reveal that the Corporation owes Morgan the money and likely has no further assets to pay. The parties may have insisted on the second term because the Bank probably has a better understanding of the Corporation's finances than Morgan. If the Bank refuses to allow renewal of the letter of credit, that probably means that the Bank is worried that the Corporation in the future will be unable to reimburse the Bank if the Bank pays the letter of credit. Morgan may wish payment in these circumstances.

B. Why might Morgan have decided to seek payment from the Bank rather than from the Corporation?

Morgan presumably thought that collecting from the Bank would be easier than collecting from the Corporation. Foreclosing on the buffalo and equipment might have been expensive and it might not have produced enough money to pay the debt. And if the Corporation had defaulted, it probably has limited assets.

C. On what grounds might Morgan argue that the Bank wrongfully dishonored the letter of credit?

Morgan might argue that the letter of credit required U.S. Bank to pay if Morgan presented "documentary evidence indicating ... that the Bank had

declined to permit the letter to automatically renew," and that Morgan did that in its certification. The Bank declined to pay based on its view of the underlying facts (i.e., whether Morgan's argument was correct), rather than what Morgan's documentary presentation said. But § 5-108(a) requires the bank to pay solely on whether the documents presented strictly conform to the letter of credit.

D. If the Bank wrongfully dishonored the letter of credit, what action might Morgan take and what remedies might it seek?

If the Bank wrongfully dishonored the letter of credit, Morgan could sue the bank for wrongful dishonor and sue the Sioux River Indian tribe for failing to pay the bonds. Morgan could recover from the Bank the amount of the letter plus attorneys fees and the expenses of litigation. Morgan could recover from the Cheyenne River Sioux Tribe the amount due on the bonds, and could foreclose on the security interest in the buffalo and equipment. But Morgan can have only one recovery.

The George Washington University Law School

May 4, 2006

Grading Guide for Final Examination In
COMMERCIAL PAPER--PAYMENT SYSTEMS
(Course No. 282-20; 3 credits)
Professor Gregory E. Maggs

PROBLEM I.

The edited excerpt is from Any Kind Checks Cashed, Inc. v. Talcott, 830 So.2d 160 (Fla. App. 2002).

Talcott --> Guarino --> Any Kind --> Dep. --> Payor --> Any Kind
drawer payee Bank Bank

A. Under what circumstances could Any Kind of Checks Cashed, Inc. recover from Talcott or Guarino?

Any Kind can enforce the check against Talcott as the drawer. 3-414(b). But Any Kind will be subject to Talcott's defense of fraud unless Any Kind is a holder in due course. 3-305(a)(2),(b).

Any Kind could recover from Guarino on his indorsement, 3-415(a), and for breach of the transfer warranty that drawer could not assert a defense against him, 3-416(a)(4).

B. The Court observed that "it is unusual for a small businessman such as a broker to conduct business through a check cashing store instead of through a traditional bank" and that Guarino previously had not done business with Any Kind of Checks Cashed, Inc. Why might these facts matter?

These facts suggest that Any Kind may not have taken the check in good faith because Any Kind did not observe reasonable commercial standards of fair dealing. 3-103(a)(6); Maine Family Federal v. Sun Life. If Any Kind did not take the check in good faith, then it could not be a holder in due course. 3-302(a)(2)(ii). If it is not a holder in due course, it would be subject to Talcott's defense of fraud. 3-305(a)(2),(b).

C. Why might Guarino have chosen to use a check cashing company instead of a bank in perpetrating his fraudulent scheme?

Guarino probably wanted to get money for the check quickly before Talcott discovered the fraud and stopped payment. The check cashing store cashed his check immediately. In contrast, a depositary bank most likely would not have given Guarino immediate credit for the check. Under Reg. CC, a depositary bank would only have a duty to give him $100 the next day, an addition $4900 by the second/fifth day (depending on whether the check was from a local or distant bank), and the remaining $5000 in a reasonable time. 12 CFR 229.10(c)(vii); 229.12(b) & (c); 229.13(b).

D. If Talcott's bank had failed to stop payment on the check, what rights would Talcott and the Bank have?

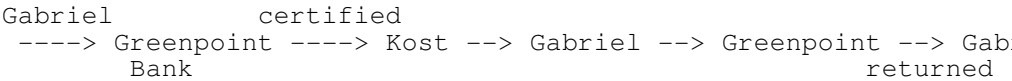
(Assumption: The words "the Bank" refer to Talcott's bank.)

Ordinarily, if Talcott had properly directed his bank to stop payment on the check, Talcott's bank could not charge Talcott's account because the check

would not be properly payable, 4-401(1), and Talcott could recover damages for failure to stop payment, 4-403(c). But in this case, having paid the check, Talcott's bank would be subrogated to the rights of Any Kind. 4-407(1). If Any Kind was a holder in due course (see above), then Talcott's bank would have the rights of a holder in due course, and could enforce the check against Talcott free of any defenses. Talcott's bank also could recover from Guarino for restitution, 3-418(a), unless Guarino relied on the payment, 3-418(c).

PROBLEM II.

The edited excerpt is from Gabriel v. Kost, 2001 WL 1491374 (N.Y. City Civ. Ct. 2001).



A. What liability would Greenpoint Bank have faced if it had paid Gabriel contrary to Kost's instruction?

None. Kost had no right to stop payment on the check after it had been certified. 4-403 cmt. 4; 4-303(1). A stop payment order must come before certification.

B. If Gabriel sues Kost, what defenses might she raise?

If Gabriel sued Kost, claiming that he never received payment of the $5,000, Kost might raise the following defenses: (1) her delivery of the cashier's check to Gabriel discharged all of her liability on any underlying obligation to pay money to him, 3-310(a); and (2) certification of her check discharged her obligation on the check, 3-414(c).

[Note even if she had not given Kost the certified check, the facts suggest that she could have asserted two defenses: (1) lack of consideration under ordinary contract law because the payment was a "gift"; or (2) even if there was a bargain between Gabriel and Kost, failure of the consideration under ordinary contract law because Gabriel did not "come back home."]

C. If Gabriel sues Greenpoint Bank, may Greenpoint Bank assert any of Kost's defenses?

No. The obligor on a instrument "may not assert against the person entitled to enforce the instrument a defense . . . of another person." 3-305(c). Greenpoint Bank therefore may assert only its own defenses.

D. What advice would you have given the parties?

Advice to Kost: Paying with a certified check is like paying with cash. Kost has no ability to stop payment or later assert defenses.

Advice to Gabriel: Taking a certified check is better than taking a personal check because the drawer cannot stop payment or assert defenses to payment. Gabriel should seek damages from Greenpoint Bank for wrongful refusal to pay a certified check. 3-411.

Advice to Greenpoint Bank: A bank that certifies its customer's check has no duty to honor the customer's stop payment orders with respect to the check. 3-305(c). And refusing to pay the certified check can expose the bank to liability. 3-411

PROBLEM III.

The edited excerpt is from NBT Bank, Nat. Ass'n v. First Nat. Community Bank, 393 F.3d 404 (3rd Cir. 2004).

HSC Inc.	--->	HSCM Inc.	--->	NBT dep. bank	-->	FRB int. bank	-->	FNCB payor bank	--->	FRB int. bank	-->	NBT dep. bank
drawer		payee										

Mar. 8 -- check deposited in NBT
Mar. 12 -- check presented to FNCB
Mar. 13 -- check returned to FRB (Federal Reserve Bank)
notice sent by NBT to FNCB
check received by FRB
Mar. 14 -- FNCB called NBT

A. Is FNCB accountable for the Disputed Check?

No. The Disputed Check was presented to FNCB on March 12. FNCB's midnight deadline for returning the Disputed Check was therefore March 13 prior to midnight. 4-104(a)(1). FNCB returned the Disputed Check before this deadline, and therefore is not "accountable" for the Disputed Check. 4-302(a)(1).

B. Why did FNCB call NBT in addition to returning the check?

Regulation CC requires a payor bank to send notice if it dishonors a check for more than $2500. 12 C.F.R. 229.33(a). Notice "may be provided by any reasonable means, including . . . telephone . . . ." Id.

C. If FNCB did not encode the Disputed Check as a "qualified returned check" before returning it, would that omission have affected its liability?

Probably not. If the payor bank determines not to pay a check, it has a duty to return a check in an "expeditious manner." 12 C.F.R. 229.30(a). The payor bank can satisfy this requirement in two ways. One way is to convert the check into a "qualified returned check" and then to return the check through the forward check collection system, 229.30(a)(2). The other way is to return the check "in a manner such that the check would normally be received by the depositary bank not later than 4:00 p.m. . . . of (i) The second business day following the banking day on which the check was presented to the paying bank . . . ." In this case, FNCB used a method of return that likely would get the check back to the depositary bank by this deadline; the check reached the intermediary bank on March 13 giving the intermediary bank until 4:00 p.m. the following day to get the check back to NBT.

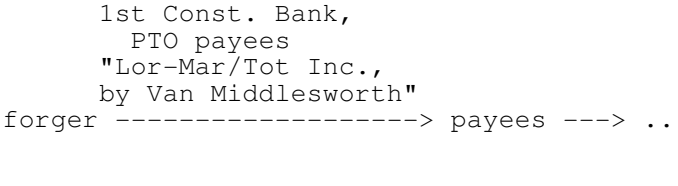
D. Who is likely to bear the loss in this case and how could that loss have been prevented?

FNCB is unlikely to bear the loss because it returned the check to NBT by its midnight deadline (see above). In theory, NBT could recover the amount of credit given to HSCM Inc. because the check was returned. 4-214(a). Or it in theory could enforce the check against the drawer. 3-414(b). But in all likelihood, HSCM Inc. has dissipated the funds from the check kiting scheme, and the drawer has no money. That's why the check bounced. As a result, NBT is likely to bear the loss. See Oakbrook Bank v. Northern Trust (on check kiting schemes).

NBT could have prevented the loss by delaying before giving HSCM Inc. full credit for the Disputed Check. NBT had no duty to give credit to HSCM Inc. for the amount of the Disputed Check in excess of $2500 until a "reasonable time" had elapsed. 12 C.F.R. 229.13(b). If it had waited, it would have learned that the Disputed Check had bounced.

PROBLEM IV.

The edited excerpt is from Lor-Mar/Toto, Inc. v. 1st Constitution Bank, 871 A.2d 110 (N.J. Super. 2005).



A. What rights does Lor-Mar have?

The problem says that the checks contain unauthorized drawer's signatures. As a result, the checks were not properly payable. Therefore, Lor-Mar has a right not have to have 1st Constitution Bank charge its account for the checks. 4-401(a). The facts do not reveal any applicable exception. Lor-Mar has no claim for conversion against the forger, the payees, or the depositary banks. 3-420(a) & cmt. 1.

B. May 1st Constitution Bank recover from the depositary banks that presented the checks?

Most likely, it cannot. If 1st Constitution Bank sought recovery in restitution, the depositary bank most likely would have a defense that the took the checks in good faith and for value or changed position in reliance on 1st Constitution Bank's payment of the checks. 3-418(c); Price v. Neal. The depositary banks would not have breached a presentment warranty to 1st Constitution Bank unless they knew that the drawer's signature was unauthorized. 4-208(a)(3).

C. Could 1st Constitution Bank avoid liability by showing that it exercised ordinary care in examining the five checks before deciding to pay them?

No. Whether 1st Constitution Bank exercised ordinary care would be relevant only if 1st Constitution Bank were attempting to assert an exception to the properly payable rule. For example, if 1st Constitution Bank argued that Lor-Mar should be precluded from asserting the signatures on the checks were unauthorized because Lor-Mar's negligence substantially contributed to the making of the forgeries, 3-406(a), Lor-Mar could argue that 1st Constitution Bank should share the loss if it also failed to exercise ordinary care, 3-406(b).

D. What advice would you give 1st Constitution Bank and Lor-Mar for avoiding this type of problem in the future?

1st Constitution Bank probably has no certain method for distinguishing authorized facsimile signatures from unauthorized facsimile signatures. Therefore, it should consider other methods for determining which checks are authorized. Some banks have developed anti-fraud measures that do not rely on the verification of signatures. These methods are described in the textbook on pp. 250-251. They include (1) requirements that customers use checks made

of specific types of paper (check stocks), which the forgers apparently did not do here; (2) and "positive pay" systems, in which the customer separately informs the payor bank of the amounts of each check that is has written. There are other methods as well. In addition, FNCB might be able to insure against losses resulting from bad checks.

PROBLEM V.

The edited excerpt is from TME Enterprises, Inc. v. Norwest Corp., 22 Cal. Rptr.3d 146 (2004).

"Pay Gaines, Trustee FBO
McDaniel, Acct. xxxxxxxx"

TME/McDaniel ----------> Pacific Bus. Bank --> Norwest Bank --> Gaines
originator originator's beneficiary's beneficiary
bank bank

A. Must Pacific Business Bank or Norwest Bank refund the money?

Norwest does not have to refund the money. It was entitled to rely on the beneficiary's account number as the proper identification of the beneficiary and did not need to determine whether the name and number refer to the same person. 4A-207(b)(1).

Pacific Business Bank may have to refund TME/McDaniel's payment if TME/McDaniel did not have notice that the beneficiary's bank might make the payment based on the account number alone. 4A-207(c)(2).

B. Might Norwest Bank be liable for negligence in accepting the wire transfer if it had notice of prior fraud by Gaines?

Probably not. The courts generally have held that article 4A preempts causes of action for negligence in executing payment orders. 4A-102 cmt; Grain Traders v. Citibank; Aleo Int'l v. Citibank; Corfan Banco v. Ocean Bank.

C. How could Appellants have ensured that their investment could only be put into an actual trust account?

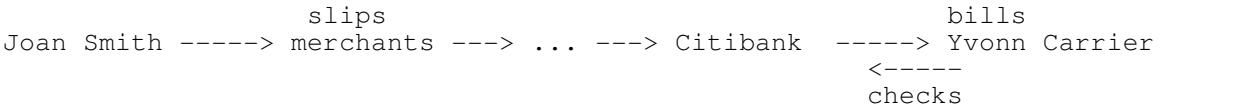
Before sending the money, they could have contacted Norwest Bank, with Gaines's permission, to verify that a trust account actually existed and to ascertain the account number for the trust account. (If Gaines refused to give permission for the Bank to disclose this information, they should have refused to do business with him.) Alternatively, they could have open a trust account at Norwest Bank themselves.

D. If Gaines had issued a forged payment order purporting to be from Appellants (instead of inducing Appellants to send the payment order), how would the parties' rights be different?

Appellants would not face any liability for an unauthorized payment order unless the payment order was "effective" and not "unenforceable." A payment order is effective if it is verified by a security procedure. 4A-202(b). A payment order is "unenforceable" if the customer proves that whoever sent the payment order did not obtain the information necessary to defeat the security procedure from the customer. 4A-203(a)(2).

PROBLEM VI.

The edited excerpt comes from Carrier v. Citibank, 383 F. Supp.2d 334 (D. Conn. 2005).



A. Were the checks issued to Citibank properly payable?

Yes. A check is properly payable if the check is authorized. The checks issued to Citibank were authorized because Carrier signed them. 3-401(a). The fact that the signatures were obtained by fraud does not make them unauthorized. It also does not matter that the checks were incomplete when they were signed. 3-115(a).

B. To what extent did Citibank have a right to payment for the charges?

The charges were unauthorized. Ordinarily, that would mean that Citibank could charge only a maximum of $50 for them. 15 U.S.C. 1643(a)(1)(B). But the Minskoff v. American Express decision controversially says that apparent authority can arise from failing to examine credit card bills and report the unauthorized charges. In this problem, Carrier did not examine his credit car bills from August 2000 until September 2002, a period of more than 2 years.

C. Does it matter that Carrier used his card "for both business and personal expenses?"

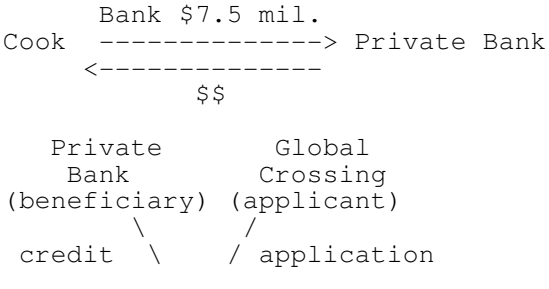
The federal statutory limitation of liability applies to business credit cards, even though it is found in the "Consumer Credit Protection Act." 15 U.S.C. 1645; Note (1), p. 186. The fact that Carrier himself had been using the card for personal expenses would make Smith's fraud even more difficulty for Citibank to detect because her personal purchases would not seem out of the ordinary. This fact thus would strengthen Citibank's position under Minskoff.

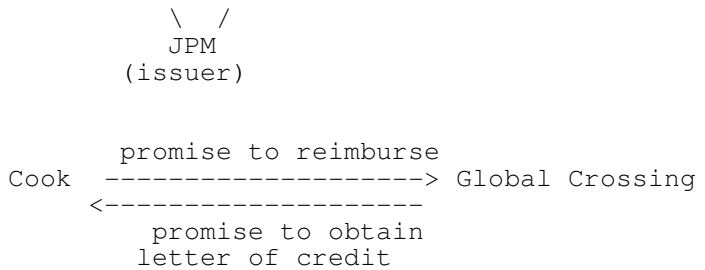
D. How could Carrier have prevented this fraud from occurring?

Carrier could have taken simple steps, such as (1) examining his credit card statements himself, (2) paying more attention when writing checks, (3) hiring an outside auditor examine the bills and checks on a regular basis, or (4) using better diligence in hiring and supervising Smith.

PROBLEM VII.

The edited excerpt is from JPMorgan Chase Bank v. Cook, 318 F. Supp.2d 159 (S.D.N.Y. 2004).





A. Did JPM have a duty to verify the factual assertions in the drawing certificate before honoring the presentation?

No. JPM is the issuer of the letter of credit. The issuer of a letter of credit merely has a duty to confirm that the presentation strictly complies with the letter of credit. 5-108(a)

B. What rights does JPM have?

JPM, the issuer, has a right to reimbursement from Global Crossing, the applicant. 5-108(i)(1). But that right may not be worth much because Global Crossing is bankrupt. In addition, JPM is also subrogated to the rights of beneficiary, Private Bank, and the applicant, Global Crossing, on the underlying obligation. 5-117(a). JPM also might have a common law right to recover the amount of the loan from Cook if JPM pays Cook's debt to Private Bank.

C. Why might Private Bank have insisted receiving a letter of credit, issued at Global Crossing request, rather than an ordinary contractual guarantee by Global Crossing?

First, the beneficiary of a letter of credit relies on the credit of the issuing bank, rather than the credit of the applicant. See casebook, p. 347. Private Bank presumably was worried, with good reason, that Global Crossing would run into financial difficulty and be unable to pay (as actually happened here). A bank has better credit. Second, a guarantee is subject to more defenses than a letter of credit; there is no independence principle.

D. If Global Crossing does not reimburse JPM, what rights will Global Crossing have against Cook and his wife?

Cook and his wife made a contract to reimburse Global Crossing "for the amount of any drawing on the [Letter of Credit]." Ultimately, $7.5 million was drawn the letter of credit. Global Crossing (or the bankruptcy trustee) might assert a claim against the Cooks for this money. Cook and his wife have no defense under the contract because Global Crossing performed its part of the bargain, namely, obtaining the letter of credit. The duty of Global Crossing to reimburse JPM is independent of this contract. 5-103(d).

[Notes: (1) JPM is not subrogated to GC's contract claim against the Cooks b/c the Cooks are neither the applicant nor the beneficiary. (2) Does this mean that the Cooks are obligated to pay both JPM (as subrogated to Private Bank's rights) and Global Crossing? Yes -- that is what the Cooks contracted to do. But presumably, if the Cooks pay JPM, Cook would be subrogated, under common law, to JPM's right of reimbursement against Global Crossing, and could set this claim off against Global Crossing's contract claim.]

The George Washington University Law School

December 16, 2004

Grading Guide for Final Examination In

COMMERCIAL PAPER--PAYMENT SYSTEM

(Course No. 280-20; 3 credits)

Professor Gregory E. Maggs

PROBLEM I. **(26 points)**

The edited excerpt in this problem comes from Noble v. Baker, 53 UCC Rep. Serv.2d 552 (Ala. Civ. App. 2004).

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       loan
Noble -------> Michael & Amy Baker

     check                              returned
Bobby --> Noble --> Alabama --> Colonial --> Alabama --> Noble
Baker              Exchange     Bank         Exchange
                   Bank                      Bank
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A. If Noble sues Bobby Baker, may Baker successfully assert lack of consideration as a defense?

No. Baker does not have a defense of lack of consideration. "If an instrument is issued for value . . . , the instrument is also issued for consideration." 3-303(b). The check was issued for value because it was "issued . . . as payment of . . . an antecedent claim against any person." 3-303(a)(3). It therefore was issued for consideration.

Note: Many answers discussed whether Noble was a holder in due course without addressing the question whether Bobby had a defense. But analysis of whether Bobby has a defense must come first because Noble could be a holder in due course only if Noble does not have notice of any defense that Bobby might have.

B. If the check's memo line had said "Payment in full of all debts owed by Michael & Amy Baker," would Noble's rights against Michael & Amy Baker be different?

No. Noble currently has the right to enforce his claim against Michael & Amy. This claim was suspended when he took the check from Bobby, but the suspension ended when the check was dishonored. 3-310(b)(3). Writing payment in full of all debts would not have changed Noble's rights; it would have proposed an accord and satisfaction. But an accord and satisfaction is effective only if the debt is unliquidated (which it apparently was not here) and if the person taking the check obtains payment (which Noble did not). 3-311(a)(iii).

C. When Colonial Bank returned the check to the Alabama Exchange Bank, what rights did the Alabama Exchange Bank have?

Alabama Exchange Bank had the right to revoke any credit that it may have given to Noble. 4-214(a).

Alternatively, because Alabama Exchange Bank became a holder when the check was deposited, 4-205(1), the bank also had a right to enforce the check against Bobby as the drawer, 3-414(a), or against Noble if Noble indorsed it, 3-415(a).

D. How would Noble's rights differ if Colonial Bank had certified the check before Bobby Baker gave it to Noble?

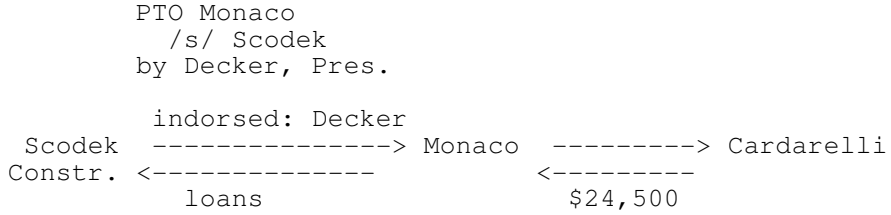
First, if Colonial Bank had certified the check, Noble could not enforce the check against Bobby Baker because the certification would have discharged him. 3-414(c).

Second, Noble also could not recover on the original debt because it would have been completely discharged when Noble took the instrument in payment. 3-310(a).

Third, Noble could enforce the instrument against Colonial Bank. 3-413(a). In addition, because it does not appear that Colonial Bank would have any defense of its own to assert, Noble could recover damages from the bank for wrongful refusal to pay the certified check. 3-411(b). Bobby Baker would not have a right to stop payment on the certified check. 4-403 cmt. 1.

PROBLEM II. (26 points)

The edited excerpt in this problem comes from Cardarelli v. Scodek Construction Corp., 758 N.Y.S.2d 188 (App. Div. 2003).



A. How should Decker have signed the notes if he wanted to make Scodek the primary obligor and wanted to guarantee payment himself only if Scodek were to default?

Decker could have made Scodek Construction Corporation primarily liable by signing the corporation's name as the maker, provided that Decker had authority to bind Scodek on a simple contract by his signature. 3-402(a). As the corporation's president, Decker presumably had this authority.

To avoid being primarily liable himself, Decker should have signed in a form showing unambiguously that his signature was made in a representative capacity on behalf of Scodek as maker. 3-402(b). For example, he could have signed: "Scodek Construction Corp. by William Decker, President." 3-402 cmt. 2.

To guarantee payment himself only if Scodek were to default, Decker should have made an anomalous indorsement of the instrument in his own name. 4-205(d). By making this indorsement, he would have undertaken to pay if Scodek did not. § 3-415(a). For example, he could have signed "Decker" on the back of the note.

Note: If Decker signed as a maker "for accommodation," he would still be primarily liable. 3-116(a).

B. Why might it make a difference whether Monaco signed or did not sign the notes before assigning them Cardarelli?

Monaco's signature might make a difference for three reasons:

First, it would simplify proof in a suit to enforce the notes. If Monaco had indorsed the notes, the assignment would be a negotiation, and Cardarelli would be a holder of the notes. § 3-201(a),(b). As a result, to

prove he was entitled to enforce, Cardarelli would only have to produce the notes. 3-308(a). By contrast, if Monaco did not indorse the notes, then Cardarelli would have to present evidence showing how he acquired the note to prove he was entitled to enforce. 3-308 cmt. 2, para. 1.

Second, if Monaco indorsed the notes, and if Cardarelli took them in good faith and without notice of any claims of defenses, Cardarelli could be a holder in due course, 3-302(a), and could take them free of any ordinary defense and claims in recoupment, 3-305(b), and competing claims of ownership, 3-306.

Third, if Monaco indorsed the notes, Cardarelli could enforce the notes against Monaco if Scodek defaulted. 3-415(a).

C. If no defenses are asserted, how much is Cardarelli entitled to recover on the notes and how much is Cardarelli entitled to recover on the loan he made to Monaco?

He is entitled to recover the full face amount of the notes, namely $25,000 + $47,000 = $72,000. The fact that the notes were discounted (i.e., exchanged for less than their face value) does not change anyone's liability on the notes.

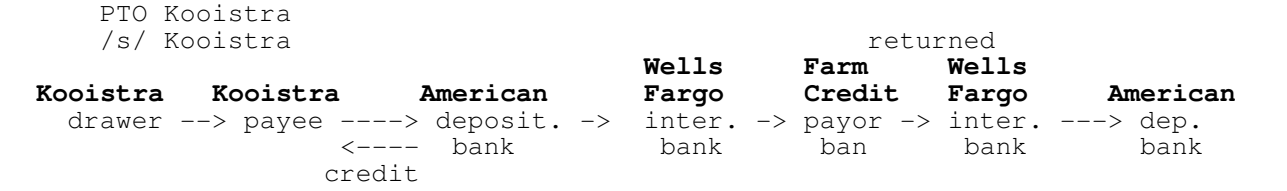
If the notes are dishonored, Cardarelli may recover either the amount of the notes or the amount of the debt. 3-310(b)(3)

D. What rights would Scodek have if Scodek mistakenly paid Monaco after Monaco assigned the notes to Cardarelli?

Ordinarily, the maker of an instrument receives a discharge only if the maker pays a person entitled to enforce. 3-602(a), (c). But the maker can also receive a discharge if the maker pays someone who formerly was entitled to enforce if the maker has not received notice that the instrument has been transferred. 3-602(b), (c). In this case, Scodek would be discharged if Scodek had not received notice that Monaco had assigned the instrument. If Scodek is not discharged, it could recover the money from Monaco under a theory of restitution. 3-418(b).

PROBLEM III. **(26 points)**

The edited excerpt in this problem comes from Farm Credit Services of America v. American State Bank, 339 F.3d 764 (8th Cir. 2003).



Deposited	Presented	Returned
Wed 8/22	Fri 8/24	Wed 8/29
Thu 8/23	Mon 8/27	Wed 8/29
Fri 8/24	Tue 8/28	Wed 8/29

A. To what extent did American have a duty to give Kooistra credit for the checks that he deposited?

This answer assumes that Saturday, 8/25, and Sunday, 8/26, are not business days.

American had a duty to give Kooistra $100 credit (or the amount deposited, if that is less) by the next business day following the day of each deposit, which means it had to give $100 credit on August 23, 24, and 25. 12 C.F.R. 229.10(c)(1)(vii).

If these checks were local checks (which seems likely given the speed with which they were presented and returned), then American had to give Kooistra up to a total of $5000 credit (or the amount deposited, if less) by the second business day following each day of deposit, which means it had to give $5000 credit on August 24, 27, and 28. 12 C.F.R. 229.12(b)(1). (If they were non-local checks, then American would have to give him $5000 credit by the fifth business day following the day of deposit, or August 29, 30, 31. 12 C.F.R. 229.12(c)(1)(i).)

American had to give Kooistra credit for the balance of the checks after a reasonable time. 12 C.F.R. 229.13(h)(1). But American could revoke the credit once the checks were dishonored. 4-214(a).

B. To what extent is Farm Credit accountable for the checks?

A payor bank is "accountable" for a check that it has settled for if it fails to return the check prior to its midnight deadline. 4-302(a)(1). The midnight deadline ordinarily is midnight on the day after the check was presented. 4-104(a)(10). But the midnight deadline may be extended by one day if the payor bank "uses a means of return that would ordinarily result in receipt by the bank to which it is sent ... on . . . the bank's next banking day following the otherwise applicable deadline." 12 C.F.R. 229.30(c)(1).

The midnight deadline for the checks presented on Friday, Aug. 24 was Monday, Aug. 27. Farm Credit missed this deadline because it did not return the checks until Wednesday, Aug. 29. It is therefore accountable for these checks.

The ordinary midnight deadline for checks presented on Monday, Aug. 27 would be Tuesday, Aug. 28. Farm Credit also missed this ordinary midnight deadline. But the midnight deadline appears to be extended by one day because the checks were sent by a method enabling them to reach Wells Fargo by Wednesday, Aug. 29 (assuming they arrived during the banking day). 12 C.F.R. 229.30(c)(1).

The midnight deadline for the checks presented on Tuesday, Aug. 28, was Wednesday, Aug. 29. Farm Credit made this deadline, and therefore is not accountable for these checks.

Note: The facts do not indicate whether Farm Credit sent notice that it was returning the checks, as is required for checks over $2500. 12 C.F.R. § 229.33. If it did not, it would be liable for damages caused. 12 C.F.R. § 229.38. But that is not the same thing as being "accountable" for the checks. 4-302(a)(1).

C. Does Wells Fargo have any claims or liabilities?

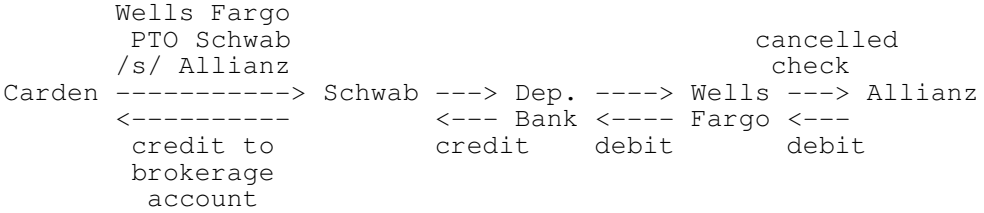
As explained in the answer to question B, Farm Credit missed its midnight deadline with respect to the checks presented on Aug. 24. Farm Credit had no right to revoke settlement for those checks, and therefore Wells Fargo is entitled to payment for those checks. 4-302(a)(1). Similarly, Wells Fargo had no right to return those checks to American because it received final payment for them. 4-215(c). Accordingly, American is entitled to payment from Wells Fargo for those checks.

D. Given that Kooistra was engaged in a check kiting scheme, what is a likely reason for Farm Credit's delay in returning some of the checks?

Because this was a check kiting scheme, Kooistra probably was depositing checks into his accounts at both American and Farm Credit. Farm Credit probably had given him provisional credit for some checks and thus mistakenly thought that he had enough money to pay the checks presented on Friday, August 24. See Oak Brook Bank v. Northern Trust.

PROBLEM IV. (26 points)

The edited excerpt in this problem comes from Travelers Cas.& Sur. Co. v. Wells Fargo Bank, 374 F.3d 521 (7th Cir. 2004).



A. What steps should Allianz take at this point?

First, Allianz should report to Wells Fargo, with reasonable promptness, that the forged check was unauthorized. 4-406(c) It also should demand that its account not be charged (or if already charged, that it be re-credited). 4-401(a). If Allianz fails to report the check with reasonable promptness, it will be liable for any loss that Wells Fargo can prove it suffered because of they delay, 4-406(d)(1), and for any subsequent forged check by the same wrongdoer prior to the bank's notification, 4-406(d)(2). And Wells Fargo has a right to charge Allianz's account, without regard to negligence or actual loss, if Allianz delays reporting for more than a year. 4-406(f).

Second, Allianz should determine how the check was forged to prevent subsequent forgeries. If Allianz's negligence substantially contributes to the making of an unauthorized signature, Allianz will be precluded from asserting that it is unauthorized. 3-406(a)

B. Why might it be relevant that two earlier suspicious checks were drawn on Allianz's account at Wells Fargo?

If Allianz did not report the prior forgeries within a reasonable time (not to exceed 30 days) after they were reported on a statement, and the forgeries were made by the same wrongdoer, then Allianz cannot assert that the $287,651.23 check was unauthorized. 4-406(d)(2).

In addition, perhaps the three forgeries all resulted from some negligence on the part of Allianz (like not taking proper care of its checkbook, etc.). As noted, if Allianz's negligence substantially contributes to the making of an unauthorized signature, it would be precluded from asserting the forgery. 3-406(a).

C. Is the bank in which Schwab deposited the check liable for conversion, liable for breach of warranty, liable in restitution, or liable under any other theory?

The depositary bank did not commit conversion. A bank is liable for conversion if it takes the check from a person who is not entitled to enforce. 3-420(a). In this case, the depositary bank took the check from Schwab.

Although Schwab was not entitled to enforce against Allianz, it was entitled to enforce against Carden (the forger). 3-403(a).

The depositary bank has no liability for breach of presentment warranty. It did not breach a presentment warranty because it was a person entitled to enforce the check (again, against Carden, not Allianz), the check was not altered, and it had no knowledge that the drawer's signature was forged. 4-208(a).

If the depositary bank transferred the check to an intermediary bank, it breached a transfer warranty that all the signatures were authentic and authorized. 4-207(a)(2). But it is unlikely that it has any liability for that breach because it does not appear to have cause the intermediary bank any damages because the check was paid. 4-207 (b).

The depositary bank also is not liable under a theory of restitution because it took the check in good faith and for value, assuming that it gave credit to Schwab (which is a likely assumption given that Schwab gave Carden credit). 3-418(c).

D. Suppose that the check had not been forged but instead that Allianz had issued the check to Schwab at the direction of someone impersonating Carden, a person to whom Allianz actually owed money. How would Allianz's rights change?

If Allianz issued the check, the check would be authorized, and Wells Fargo could charge Allianz's account for it. 4-401(a). Note that the impostor rule does not apply here because Allianz did not issue the check "to the impostor, or to a person acting in concert with the impostor"; instead, it issued the check to Schwab. 3-404(a) & cmt. 1.

Allianz could attempt to recover the money from Schwab under a theory of restitution. But Schwab could argue that it was not unjustly enriched because the money has been withdrawn.

PROBLEM V. (26 points)

The edited excerpt in this problem comes from Regatos v. North Fork Bank, 257 F. Supp.2d 632 (S.D.N.Y. 2003).

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      PAY Citibank
      /s/ Regatos
Thief -------------> CBNY  --------> Citibank
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A. How might the funds transfers have occurred?

According to the facts, it is to be assumed that both Regatos and Abadi are telling the truth. That means that Regatos did not authorize the funds transfers, but Abadi somehow received genuine-looking payment orders and genuine-sounding telephonic verifications.

The funds transfers therefore probably occurred because someone other than Regatos sent the payment orders to CBNY and then called Abadi on the telephone. The perpetrator somehow must have known (1) that Regatos had an account at CBNY; (2) what Regatos's account number was; (3) what Regatos's payment orders looked like; and (4) that Regatos verified his payment orders by calling Abadi at CBNY. In addition, the perpetrator must have sounded like Regatos on the telephone.

B. May CBNY charge Regatos for the two funds transfers?

A bank may charge a customer for a payment order if the payment order is authorized or if it is effective and not unenforceable. If Regatos is telling the truth then these funds transfers were not authorized because neither he nor an agent of his sent them. 4A-202(a). A funds transfer is effective if it has passed a reasonable security procedure. 4A-202(b). If Abadi is telling the truth, then the funds transfers passed a security procedure consisting of a call to Abadi. But it is not clear that the security procedure is reasonable if someone can defeat it simply by calling on the telephone and saying that he is Regatos. What is reasonable depends on the circumstances and the available alternatives. 4A-202(c). If there is no other evidence -- as the facts say -- a court might conclude that the reasonableness of the security procedure has not been established, and the payment order is not effective.

Even if a payment order is effective, the payment order is not enforceable if the account owner proves that whoever defeated the security procedure did not get the information from him. 4A-203(a)(2). If there is no other evidence -- as the facts say -- then Regatos cannot prove how the security procedure was defeated. He therefore cannot show that the funds transfers were unenforceable (if they are effective).

C. If Abadi did not exercise reasonable care in obtaining telephonic verification of these payment orders, may Regatos recover from CBNY for negligence?

The courts generally have held that article 4A preempts causes of action for negligence in executing payment orders. 4A-102 cmt; Grain Traders v. Citibank; Aleo Int'l v. Citibank; Corfan Banco v. Ocean Bank. Regatos, however, may contend that this preemption should not apply when he alleges that he never executed a payment order. Cf. Corfan Banco v. Ocean Bank (leaving open the question whether article 4A precludes negligence claims in all cases).

D. What simple steps could Regatos and CBNY take to prevent similar problems from arising in the future?

Ragatos and CBNY should change their security procedures. One step would be to have Abadi call Regatos at his home to verify that he sent the payment (rather than having Regatos call Abadi). Another would be to have a password that only Regatos knows. See Casebook p. 219.

PROBLEM VI. (26 points)

The edited excerpt in this problem comes from DBI Architects, P.C. v. American Express Travel-Related Services Co., Inc., 2004 WL 2514451 (D.C. Cir. 2004).

A. If DBI had told AMEX that Moore's charges were fraudulent immediately after receiving the first billing statement showing the charges, what liability would DBI, AMEX, and the merchants who took the charges have?

If the credit card charges were authorized, then DBI would be liable for all of them. If the charges were unauthorized, DBI would be liable for a maximum of $50. CCPA §§ 133(a), 135; 15 U.S.C. §§ 1643, 1645. DBI could avoid even this $50 liability if it could show that Moore did not have authority to "accept" the credit card. Id. If the charges were unauthorized, AMEX presumably could charge them back to the merchants pursuant to private agreements (and the merchants then would seek to recover them for Moore). The important issue, therefore, is whether Moore had authority to apply for, accept, and make charges with the cards.

Actual authority, whether expressed or implied, is authority that the principal gives to the agent. The facts suggest that DBI told AMEX that

certain of its employees could use a credit card on the corporate account but did not tell AMEX that Moore could use one. That suggests that Moore did not have express authority. But AMEX has a very strong argument that DBI made Moore the "account manager," and that by putting Moore in that position, DBI gave her implied authority both to apply for and use a corporate credit card.

Even if Moore did not have express or implied authority, she may have had apparent authority. Apparent authority is authority that arises by estoppel. If the principal's negligence causes third parties to believe that a person has authority, the principal may be estopped to deny it. Casebook, p. 186. But it is difficult to see how DBI was negligent if -- as question A asks us to assume -- DBI immediately reported the fraudulent charges.

B. To what extent would the delay in reporting unauthorized charges to the AMEX affect the parties' liability?

In the leading case of Minskoff v. American Express, the court held that delay in reporting fraudulent charges could create apparent authority for subsequent charges. If this decision is followed, then DBI would be liable for charges made by Moore after DBI had a reasonable time to inspect its statements, even if Moore did not have actual authority to make the charges.

The Minskoff case has been criticized as an incorrect interpretation of the Consumer Credit Protection Act. The criticism is that Minskoff does not focus on whether merchants would think that the user of a credit card has authority but instead on what the card issuer would think. Casebook, pp. 186-187. If that criticism is correct, then the question would be whether DBI was negligent in a way that created false beliefs in the merchant. That is possible, at least for some of the later transactions, if exercising ordinary care would have meant taking the card from her.

C. If Moore had paid the merchants with checks drawn on DBI's corporate account instead of paying them with the AMEX card, how would DBI's liability differ?

The facts say that Moore controlled "corporate checking" and that she issued checks on behalf of DBI. So it appears that Moore had authority to sign the DBI's corporate checks. Under the properly payable rule, the drawee bank therefore could charge DBI's account for all of the checks. 4-401(a).

DBI might seek to assert a claim to the proceeds of the checks against merchants on grounds that Moore fraudulently made purchases for her personal use. 3-202(b); 3-306. If the merchants are holders in due course, they would not be subject to this claim. 3-306. But DBI might argue that the merchants cannot be holders in due course because if they took the checks "in a transaction known by the taker to be for the personal benefit of the fiduciary," they had notice of Moore's breach of her fiduciary duty to DBI. 3-307(b)(4)(ii); Smith v. Olympic Bank.

(If Moore did not have authority to issue the checks, they would not be properly payable unless some exception applied. A likely exception would be the "same wrongdoer" exception in 4-406(d)(2).)

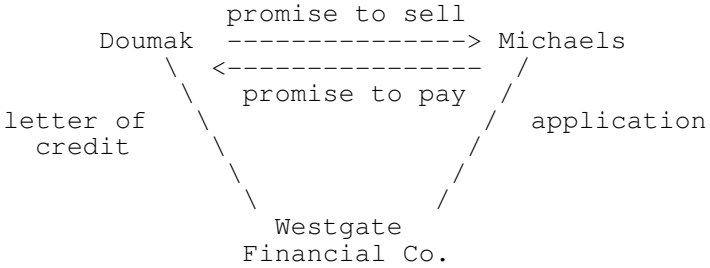
D. How should DBI and AMEX have sought to prevent fraud of this type?

DBI and Amex could have sought to prevent this fraud in at least three ways. First, DBI could have sought to hire more trustworthy employees. Second, DBI should have kept better track of its business. It did not know for several months that (1) Moore had applied for a card; (2) Moore had used the card for personal purchases; and (3) Moore had paid for the purchases with company checks. Cf. Minskoff. DBI also should have had another employee or an outside auditor examine the records revealing this kind of information on a

regular basis. Third, DBI also should have made an agreement with AMEX limiting who can authorize the issuance of a credit card on its corporate account. Fourth, AMEX and DBI should have agreed on a system for monitoring purchases on the corporate credit card, which would have flagged items (like expensive clothes) that a corporation would be unlike to purchase. There are many other possible recommendations.

PROBLEM VII. **(26 points)**

The edited excerpt in this problem comes from J.P. Doumak, Inc. v. Westgate Financial Corp., 4 A.D.3d 62 (N.Y. App. Div. 2004).



A. Is Westgate liable to Doumak?

Westgate had a duty to honor Doumak's documentary presentation only if it appeared "on its face strictly to comply with the terms and conditions of the letter of credit." 5-108(a). If the inclusion of a written demand for payment was a "term" or "condition" of the letter of credit -- which it appears to have been -- then Doumak's presentation did not strictly comply. Although issuers of letters of credit cannot insist on "slavish conformity," 5-108 cmt., they certainly do not have to overlook missing documents. If the parties disagree, they could present expert witnesses to testify about the standard practice of issuers. 5-108(e).

Doumak's best argument is that the demand for payment was not a condition on Westgate's liability under the letter of credit, but just an instruction telling Westgate when to pay, and that this instruction was implicit in its presentation.

B. What are the rights and liabilities of Michaels?

Michaels is liable to pay Doumak for the goods under their contract. If a presentation under a letter of credit is dishonored, the beneficiary may enforce any contract rights that he or she has against the applicant. 5-103(d); 2-325. It does not matter whether the letter of credit was rightly or wrongly dishonored.

Michaels has no liability to Westgate Financial because Westgate dishonored the letter of credit. Cf. 5-108(i)(1) (applicant liable for reimbursement only if issuers has honored the letter of credit). Again, it does not matter whether the letter of credit was rightly or wrongly dishonored.

If Westgate Financial wrongfully dishonored the letter of credit -- see part A above -- then Doumak would have a claim for wrongful dishonor. Doumak could recover incidental expenses and the costs of litigation. 5-111(b), (e).

C. How would the rights of the parties be different if Westgate Financial had called the document that it issued to Doumak a guaranty instead of a letter of credit?

The label on a document is not conclusive on the issue of whether it is a letter of credit or guarantee. 5-102 cmt. 6. In Wichita Eagle v. Pacific Nat'l Bank, the court said that a document that was called a "letter of credit" was actually a mere guaranty. A court similarly might reason that calling a document that otherwise would be a letter of credit a "guaranty" does not prevent it from being a letter of credit. Cf. § 5-104 (specifying the minimal formal requirements for a letter of credit).

But perhaps there is a difference. If the issuer calls the document a "guaranty," that might indicate that the issuer wants to have all of the rights of a guarantor. In particular, if Westgate Financial merely had guarantied payment, there would be two differences in Westgate's rights. First, Westgate would not be liable unless Michaels failed to pay. Second, Westgate also could assert any defense that Michaels might have.

D. In the future, would Doumak do better to insist on payment by credit card rather than a letter of credit?

Credit cards and letters of credit are similar in an important way: whenever merchants take payment by a credit card or letter of credit, they rely on the credit of the issuer rather than the purchaser.

Credit cards have some advantages over letters of credit. One is that they are easier for buyers to use. In addition, a merchant taking payment by letter of credit does not have to worry about submitting strictly conforming documents in order to obtain payment; instead, the merchant merely transfers the credit card slip.

But there are several disadvantages to sellers in taking payment by credit card. First, the merchant would be subject to a discount of about 2%-4%, which could be a significant amount on a large transaction. Second, many buyers might not be able to make large payments on their credit cards because of limits on their available credit. Third, at least when dealing with consumers, the merchant might worry that the credit card issuer will charge back the amount of the charge if the customer asserts that the goods are defective. CCPA § 170, 15 U.S.C. § 1666i. (Non-consumers do not have a statutory right to dispute charges, but credit card issuers might attempt to charge back charges as an accommodation.)

The George Washington University Law School

December 18, 2003

Grading Guide for Final Examination In

COMMERCIAL PAPER--PAYMENT SYSTEM

(Course No. 202-11; 3 credits)

Professor Gregory E. Maggs

PROBLEM I. **(26 points)**

The edited excerpt in this problem comes from Baker v. First American Nat. Bank, 111 F. Supp.2d 799 (W.D. La. 2000).

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    certificate
    of deposit
CNB ------------> Mrs. Baker
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A. Do the terms of the certificate of deposit prevent it from being a negotiable instrument?

Certificates of deposits ordinarily are negotiable instruments. 3-104(j). The terms making the CD payable to Mrs. Baker's order and specifying the interests payable do not prevent the CD from being a negotiable instrument. 3-104(a)(1) & 3-112(a). But the notation saying that the CD is "NONTRANSFERABLE" appears to be "a conspicuous statement, however expressed, to the effect that the promise or order is not negotiable." 3-104(d). The statement is conspicuous. 1-201(b)(10). A non-transferrable instrument cannot be a negotiable instrument because voluntary negotiations are a form of transfer. 3-201 & 3-203.

B. Why would it matter to Mrs. Baker whether the certificate of deposit is a negotiable instrument?

Mrs. Baker might prefer to have a negotiable instrument for several reasons. First, and most importantly for this problem, the statute of limitations for a certificate of deposit that is a negotiable instrument does not begin to run until 6 years after demand for payment. 3-118(e). Second, Mrs. Baker could establish the required proof necessary for enforcing a negotiable instrument in a lawsuit simply by attaching the note to her complaint. 3-308. Third, Mrs. Baker could more easily sell a negotiable certificate of deposit or pledge it as collateral for a loan.

C. Why might Commercial National Bank prefer to issue a certificate of deposit that is not a negotiable instrument?

If the certificate of deposit is not negotiable or transferrable, Commercial National Bank would know that it only has to pay the original purchaser of the instrument. The bank also could avoid have any defenses (like discharge through prior payment or failure of the consideration) stripped away by a negotiation to a holder in due course. In addition, as this problem shows, the bank could take advantage of a shorter period of limitations.

D. Would U.C.C. articles 3 and 4 have any relevance with respect to a certificate of deposit that is not a negotiable instrument?

Article 3 technically would not apply to an instrument that is not a negotiable instrument, but a court might apply its provisions by analogy. 3-104 cmt. 2 (end of comment).

Article 4 applies to "items." An item is "an instrument or a promise or order to pay money handled by a bank for collection or payment." 4-104(a)(9). A non-negotiable certificate of deposit is a promise to pay. To the extent that it is "handled by a bank for collection or payment," it would be governed by article 4.

PROBLEM II. **(26 points)**

The edited excerpt in this problem comes from Patriot Bank v. Navy Federal Credit Union, 58 Va. Cir. 251 (2002).

NFCU --> Peeso --> Nation's Auto --> Patriot Bank --> NFCU --> Patriot Bank --> Nation's Auto

A. Were Peeso, Nation's Auto, and Patriot Bank ever holders of the cashier's check?

Peeso was the holder of the cashier's check when NFCU first issued it to him because the cashier's check was payable to him and he was in possession. 1-201(b)(21).

Nation's Auto became a holder upon negotiation of the check by Peeso. 3-201(a).

Patriot Bank was a holder because a depositary bank is automatically a holder of a check deposited by a holder. 4-205(1).

B. What rights does Patriot Bank against the other parties?

[Note: The facts say that "Patriot Bank returned the check to Nation's Auto." Accordingly, Patriot Bank no longer has possession of the check.]

Against Nation's Auto: Patriot Bank may recover the credit given to Nation's Auto for the check because the check was dishonored. 4-214(a). [Nation's Bank made a mistake in returning the check to Nation's Auto before seeing whether Nation's Auto had enough money in its account. Accordingly, equitable principles may require Nation's Auto to hold the check in constructive trust for Patriot Bank.]

Against Peeso: Patriot Bank cannot recover from Peeso because it no longer has possession of the cashier's check. [If it had not returned the check to Nation's Auto, it could have enforced the check based on Peeso's indorsement. 3-415(a).]

Against NFCU: Patriot Bank was a holder and thus was a person entitled to enforce when NFCU dishonored the cashier's check. Accordingly, NFCU may have a claim against NFCU for wrongful refusal to pay a cashier's check. 3-411(b). NFCU, however, might argue that Patriot Bank cannot recover expenses or consequential damages because it has "a reasonable doubt whether the person demanding payment is the person entitled to enforce" given the absence of an indorsement by Nation's Auto.

C. If Nation's Auto repays Patriot Bank the credit given for the check, would it have any rights against Peeso?

Nation's Auto cannot recover from Peeso for the price of the car because the Peeso's obligation to pay for the car was discharged when Nation's Bank took the cashier's check as payment. 3-310(a).

Nation's Auto, however, may enforce the check against the Peeso based on Peeso's indorsement. 3-415(a). [Peeso then could enforce the check against NFCU. 3-412's last sentence.]

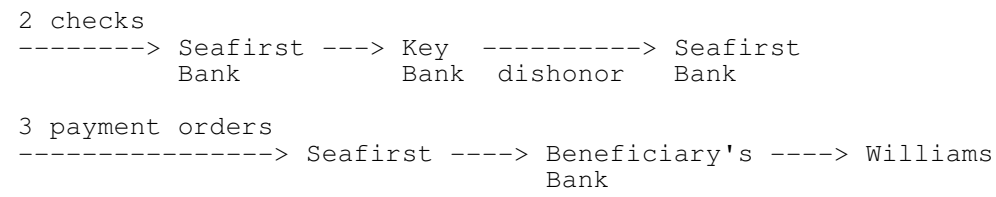
D. What were the advantages and disadvantages to Peeso of making the cashier's check payable to himself instead of payable to Nation's Auto?

One advantage of making the check payable to himself was that Peeso could negotiate the check to anyone he wanted and did not have to negotiate it to Nation's Auto. This was an advantage because Peeso may have changed his mind and wanted to buy a car from someone else. Another advantage was that the check was less attractive to thieves; if the check were payable to Nation's Auto, a thief could have used the check to buy a car from Nation's Auto.

The disadvantage in making the check payable to himself was that he had to indorse the instrument and thus incurred indorser liability. 3-415(a). He might have avoided this liability by indorsing without recourse, but he did not do that. 3-415(b).

PROBLEM III. **(26 points)**

The edited excerpt in this problems comes from Bank of America v. David W. Hubert, 62 P.3d 904 (Wash. App. 2003).



A. In carrying out her fraudulent scheme, what did Williams gain by depositing her checks in the IOLTA account before transferring money from the IOLTA account to herself?

She was able to withdraw not only the money that was already in the account but also the provisional credit given for her checks.

[If you were inclined to do the math, the bank account apparently initially had a balance of $107,857.15. The provisional credit for the deposit of the checks increased the balance to $301,723.59. The wire transfers decreased the balance to $130,012.98. The revocation of the provisional credit then reduced the balance to negative $63,853.46. So if she had not made the transfer and received the credit, she could have withdrawn $63,853.46 less.]

B. To what extent did Seafirst have to give provisional credit to the IOLTA account for the deposited checks.

The bank had to give: (1) $100 credit by the next day, Reg. CC 229.10(c)(vii)(A); (2) $5000 credit by the second day if Key bank was a local bank or by the fifth day if Key Bank is a non-local bank, id. 229.13(b); and (3) the balance of the check in a reasonable time, id. 229.13(h)(2).

C. If Key Bank had returned the IOLTA checks on September 23 instead of September 22, could it have avoided liability?

[Note: Under the UCC and Reg. CC, a check is "returned" when it is sent, not when it arrives at its destination. 4-301(d), Reg. CC 229.30(a).]

If the checks arrived on September 21, then Key Bank's midnight deadline would be midnight on September 22. Ordinarily, if it returned the check on

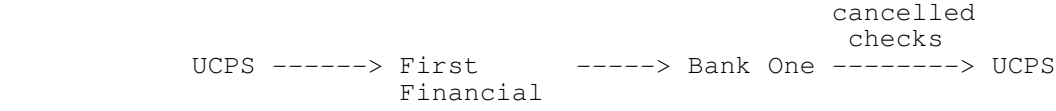
September 23, it would have missed its midnight deadline and would be accountable for the check. 4-302(a)(1). But if Key Bank used a highly expeditious method of return that ordinarily would get the check to Seafirst before the end of the day on Sept. 23, then the midnight deadline would be extended. See Reg CC 229.31(c)(1); First Nat'l Bank v. Standard Bank. The midnight deadline also could be extended if the delay was beyond the control of the bank. 4-109b); Blake v. Woodford Bank & Trust.

D. If Seafirst had delayed in revoking the provisional credit given for the deposited checks, how might the delay have affected Seafirst's rights?

A depositary bank may revoke provisional credit given for a deposited check that has been dishonored "by its midnight deadline or a longer reasonable time after it learns the facts." 4-214(a). If the delay did not extend beyond this time, then the delay would not affect Seafirst's rights. Even if Seafirst delayed beyond a reasonable time, it still could revoke the credit but would be liable for whatever damages the delay caused its customer. 4-214(a). It is unclear how further delay would cause damages in this case.

PROBLEM IV. **(26 points)**

The edited excerpt in this problem comes from United Catholic Parish Schools of Beaver Dam Educational Ass'n v. Card Services Center, 636 N.W.2d 206 (Wis. App. 2001).



A. How should a court evaluate First Financial's conversion claim and UCPS's affirmative defense to this claim?

It is unclear whether Gittus, as the bookkeeper, had authority to sign UCPS's checks on behalf of UCPS. The conversion claim is invalid either way. If Gittus had authority to issue the checks on behalf of UCPS, UCPS has no claim for conversion because the issuer of a check cannot recover for conversion. 3-420(a)(i). If Gittus had no authority to issue the checks on behalf of UCPS, then UCPS has suffered no injury because Bank One cannot charge its account for the checks.

In addition, First Financial did not commit conversion. It was not in wrongful possession of the checks and did not take the checks by "transfer" from a person not entitled to enforce. Instead, the checks were issued to First Financial.

Although First Financial was the payee of the checks, it still may have been a holder in due course of the checks. 3-302 cmt. 4. First Financial appears to have taken the checks in good faith and for value (i.e., the discharge of Gittus's credit card debt). 3-302(a); 3-303(a)(3). The only question is whether First Financial's notice that the check was drawn on UCPS's account was notice of a defense. That seems unlikely because First Financial had no way of knowing that Gittus was misappropriating funds; First Financial might have thought that UCPS was reimbursing Gittus for legitimate expenses. If First Financial was a holder in due course, it would take the checks free of competing claims of ownership, which would be the basis for any conversion claim. 3-306.

Note: Section 3-405 has no relevance because there was no employee forgery of an indorsement.

B. Could UCPS recover from First Financial under a theory of restitution or some other theory besides conversion?

If Gittus had authority to sign the checks, then the checks were not paid by mistake, and the rules in 3-418 do not apply. And even if UCPS claimed that First Financial was unjustly enriched, the discharge for value rule might prevent recovery in restitution because First Financial took the checks in payment of a debt. Banque Worms v. BankAmerica.

If Gittus did not have authority to sign the checks, and the checks were paid by mistake under 3-418(a), the Price v. Neal exception would prevent recovery if First Financial took the checks in good faith and for value.

First Financial did not breach a presentment warranty because it was a person entitled to enforce, regardless of whether Gittus had authority to sign UCPS's checks.

C. What rights do UCPS and Bank One have with respect to each other?

Bank One can charge UCPS's account for checks that are properly payable. 4-401(a). As the bookkeeper, Gittus presumably has authority to issue the checks. The checks therefore appear to be properly payable.

If Gittus did not have authority to issue checks for UCPS, then the checks would not be properly payable unless some exception applied. Possible exceptions include negligence and reporting delay. 3-406(a); 4-406(d).

D. In the future, how should UCPS attempt to prevent losses from this kind of embezzlement?

UCPS should take greater care in hiring and supervising its bookkeeper and should have an independent person examine its books from time to time. Cf. Gina Chin & Assocs. v. First Union. UCPS obviously should fire Gittus immediately. UCPS also could require multiple signatures on its checks or give BankOne a list of proper payees.

PROBLEM V. (26 points)

The edited excerpt in this case comes from Centre-Point Merchant Bank Ltd. v. American Express Bank Ltd., 43 UCC Rep. Serv.2d 372 (S.D.N.Y. 2000).

8/18: Centre Points asked Amex to invest $1.598M

8/19: Amex transfers $702,976 based on a fraudulent payment order

A. May Amex cancel the second fraudulent payment order?

After a payment order has been accepted, cancellation is not effective unless the receiving bank agrees. 4A-211(c). And if the payment order has been accepted by the beneficiary's bank, cancellation is not effective unless the order was issued in execution of an unauthorized payment order, etc. 4A-211(c)(2). The beneficiary's bank probably will not agree to cancellation if the beneficiary already has withdrawn the money (which it probably has).

[Note: Technically, Amex would not be cancelling the fraudulent payment order but instead the payment order that it issued in execution of the fraudulent payment order.]

B. Under what circumstances, may Amex charge Centre-Point for the fraudulent payment order?

Even if the payment order was unauthorized, Amex may charge Centre-Point's account for the order if it was verified by a commercially reasonable security procedure that the parties agreed upon (which the Test Key agreement presumably was). 4A-202(b). But Amex could not charge Centre-Point if Centre Point showed the payment was unenforceable because whoever issued did not obtain information on how to defeat the security procedure from Centre-Point. 4A-209(a)(2). Centre-Point probably would have difficulty finding such proof because if it does not know who defeated the security procedure.

C. May Centre-Point recover from Amex for negligence?

Most courts say that article 4A precludes actions for negligence in handling fund transfers. 4A-102 cmt.; Grain Traders v. Citibank. But here the facts indicate that Centre Pointe is not arguing that Amex was negligent in handling of a funds transfer. Instead, Centre-Point is arguing that Amex was negligent in not reinvesting the money into an investment account at the bank. Article 4A would not appear to preclude an action for this kind of negligence in banking services unrelated to funds transfers. More facts would be necessary to decide if Amex actually was negligent. For example, maybe Amex had no duty to reinvest the money.

D. How would the rights of the parties have differed if Amex had paid a check for $702,976.63 fraudulently drawn on account instead of accepting a fraudulent payment order?

A bank may charge a customer's account for an unauthorized payment order only if it is verified and not unenforceable. That is likely in this case if the payment order passed the security procedure.

A bank may not charge a customer's account for an unauthorized check. 4-401(a). But various exceptions (including those pertaining to negligence that contributes to the making of a forged signature or reporting delay) may preclude a customer from asserting that a check is unauthorized. These exceptions do not appear likely here.

PROBLEM VI. (24 points)

The edited excerpt in this case comes from Citibank v. Hauff, 668 N.W.2d 528 (S.D. 2003).

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           cards
Citibank ----------> Tonette & David Hauff
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A. What arguments should Tonette and Citibank make on the question of whether Tonette is liable for David's charges?

Tonette's best argument is that she is not liable for David's charges because the renewal credit cards were not accepted by her and because David had no authority to accept them for her. CCPA 133(a)(1)(A). Under the contract, David had authority to use the original cardsto make charges, not to accept and use renewal cards. (CCPA 102(l) defines an "accepted credit card" as "any credit card which the cardholder has requested and received or has signed or has used, or authorized another to use . . . .")

Citibank's best argument is that David had authority to accept the renewal credit cards on Tonette's account because Tonette had not revoked David's authority to "use [her] account" and accepting renewal cards is one method of using her account. The agreement clearly allows David to continue to use cards if they are accepted.

Citibank also might argue that Tonette agreed to pay for all charges that

David made on her "account" and that these charges were made by David on her "account" even though they were made on an unaccepted renewal card. Private agreements, however, generally cannot defeat the protection of CCPA 133(a)(1)(A).

[Note that Citibank could send her a renewal card even if she did not request it. CCPA 132.]

B. Under what circumstances, if any, might Citibank recover from the merchants at which David made the charges?

If the charges were authorized, then Citibank must collect from Tonette (or David) and cannot recover from the merchants. The merchants might argue that David had actual authority using Citibank's arguments above. Alternatively, they might argue that he had apparent authority because Citibank issued the credit card to him in his name.

If the charges were not authorized, Citibank's right to charge back the amount of the charges to the merchants would depend the contractual terms governing a merchant's acceptance of credit cards. These terms generally provide that the merchant bears the risk that the person using the credit card is not a person who is authorized to use the card. See casebook at 214.

C. What advice would you give Citibank for drafting its credit card agreements in the future?

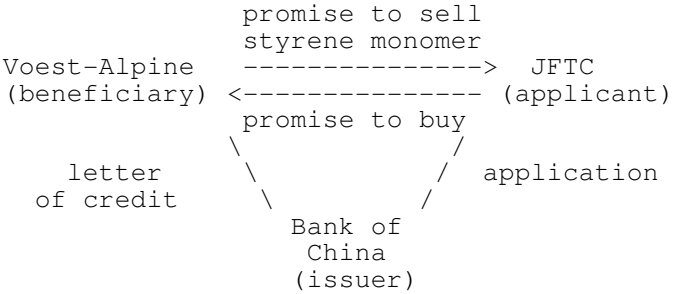
Citibank should have specified more clearly in the agreement that previously authorized persons such as David may accept renewal cards unless their authority has been removed. Citibank also might specify that anyone residing at the cardholder's previous address may accept a card on behalf of a cardholder if the cardholder has not notified Citibank that he or she is moving.

D. What should Tonette have done differently to avoid the dispute that she had with Citibank?

Tonette should have cancelled her account and not simply paid off the balance of the account. She also should have notified Citibank that David no longer was authorized to "use" her account. In addition, she should have notified Citibank of her change of address.

PROBLEM VII. **(26 points)**

The edited excerpt in this case comes from Voest-Alpine Trading USA Corp. v. Bank of China, 288 F.3d 262 (5th Cir. 2002).



A. How should a court assess whether Bank of China properly dishonored the letter of credit?

A bank must honor a presentation that strictly complies with the letter of credit. 5-108(a). Whether there has been strict compliance depends on the standard practice of banks issuing letters of credit. 5-108(e). Voest-Alpine's failure to include two additional copies of the bill of lading appears trivial, but the differing identifications of the beneficiary might cause confusion. American Coleman v. Intrawest Bank.

B. If the listed discrepancies did not warrant dishonor, may Bank of China later identify other discrepancies?

No. The issuer cannot identify additional discrepancies. See 5-108(c). Note that the court American Coleman said that the an issuer was estopped from raising additional discrepancies only when the beneficiary relied. But as we discussed in class, the revised version of article 5 changes that rule in 5-108(c).

C. What rights, if any, does Voest-Alpine have against JFTC?

If a letter of credit has be dishonored, the seller of goods may enforce the contract against the seller. UCC 2-325(2). The letter of credit is independent from the underlying sales contract between JFTC and Voest-Alpine. 5-103(d).

D. Assume JFTC had implored Bank of China to "find some reason for dishonor because we no longer want to pay $1.2 million for the styrene monomer." What advice would you have given Bank of China?

If the Bank of China can find a discrepancy that would justify dishonoring the letter of credit in standard practice, Bank of China not only should but must dishonor it. 5-108(a). Otherwise, it cannot charge JFTC. 5-108(i)(1).

If Bank of China cannot find a discrepancy that would be a basis for dishonoring the letter of credit in standard practice, Bank of China should recognize its potential liability for wrongful dishonor. A bank that wrongfully dishonors a presentation is not only liable for the amount of the letter of credit, but also for incidental damages, and expenses of litigation, including attorney's fees. 5-111(a). Bank of China either should honor the presentation or should require JFTC to indemnify it for any liability that might arise from wrongfully dishonoring the letter of credit. Dishonoring also might hurt Bank of China's reputation.

The George Washington University Law School

December 19, 2002

Final Examination In

COMMERCIAL PAPER--PAYMENT SYSTEMS

(Course No. 282-20; 3 credits)

Professor Gregory E. Maggs

PROBLEM I.

The edited excerpt comes from Coregis Ins. Co. v. Fleet Nat. Bank 793 A.2d 254 (Conn. App. 2002).

Fields --> Carney --> Ancona's --> Deposit. --> Bank --> Ancona's
Bank of Zachary

A. What rights, if any, does Ancona's have against Fields, Carney, and the Bank of Zachary?

Against Fields: Assuming that Carney indorsed the check when he cashed it, Ancona's became a holder of the check. Accordingly, Ancona's may enforce the check against Fields now that it has been dishonored and returned. 3-414(b). If Ancona's took the check in good faith and without notice of Field's dispute with Carney, Ancona's would be a holder in due course. 3-302. Ancona's therefore would not be subject to Fields's apparent defense of failure of consideration. 3-305(b).

Against Carney: Ancona's may recover from Carney based on his indorsement of the check. 3-415(a). In addition, Carney appears to have breached a transfer warranty that the instrument was not subject to a defense. 3-416(a)(4).

Against the Bank of Zachary: Ancona's has no claim against the Bank of Zachary if the Bank of Zachary returned the check in a timely and expeditious manner. The drawee owes no obligation to the holder to pay an uncertified check. 3-408.

B. If the Bank of Zachary mistakenly had paid the check despite the stop payment order, what could it recover from Fields, Carney, Ancona's, and the depositary bank?

From Fields: Assuming the Bank of Zachary had a reasonable opportunity to act on the stop payment order, the check would not be properly payable, and the Bank of Zachary would not have a right to charge Field's account. 4-401(a). The Bank of Zacharary, however, would be subrogated to Ancona's rights as holder in due course. 4-403 cmt. 7; 4-407. The Bank therefore could enforce the check against Fields as the drawer. 3-418(d).
From Carney: The Bank of Zachary also could enforce the check against Carney based on his indorsement. 3-418(d); 3-415(a).

From Ancona's and the Depositary Bank: Although the Bank of Zachary might seek restitution from either the Depositary Bank or Ancona's, the Price v. Neal exception in 3-418(c) probably bars recovery. Both appear to have acted in good faith. Ancona's took the instrument for value and the depositary bank may have as well.

C. If Ancona's requires Carney to return its payment for the check, what rights would Carney have?

As indorser required to pay the check, Carney would have the right to enforce the instrument against Fields. 3-414(a)'s last sentence. Fields, however, could assert the defense of failure of the consideration (or whatever other defense he might have) because this defense arose out of the transaction giving rise to the instrument. 3-305(b).

Carney also could enforce the underlying obligation, subject to defenses. Although the underlying obligation was suspended, the suspension ceased when the check was dishonored. 3-310(b)(2).

D. What advice would you give Fields for the future if he must pay a contractor in advance?

If Fields must pay in advance, he runs the risk that the contractor will do poor or incomplete work and not return the money. He needs protection against this possibility.

The ability to stop payment on a check provides only limited protection against this possibility, as this case shows, because the bank may pay the check before a stop payment order is issued or the check may end up in the hands of a holder in due course.

Fields might do better to pay with a credit card because then he could assert defenses against the issuer. CCPA 170. Alternatively, he might ask the contractor to provide a standby letter of credit requiring a bank to repay the money if Fields asserts the work is unsatisfactory. Cf. Wichita Eagle v. Pacific Nat'l Bank.

Note: Placing the payment in escrow or payiung Carney with a letter of credit requiring evidence of completion also would protect Fields, but it is not really paying the contractor "in advance" because the contractor would not receive the money until later.

PROBLEM II.

The edited excerpt comes from In re Couchot, 169 B.R. 40 (Bankr. S.D. Ohio 1994).

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             note
Kathy & Jean ----> Star Bank

          check
Star Bank -----> Jean
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A. How much may Star Bank recover from Kathy and from Jean?
Star Bank may enforce the note against either one of them. As co-makers, they are jointly and severally liable for the entire amount of the note. 3-116. Star Bank thus may recover $6317.48 from either one.

B. What rights would Kathy and Jean have against each other if they each paid a portion of the note?

An accommodation party is person who signs an instrument without being a direct beneficiary of the value given for the instrument. 3-419(a). Kathy may argue that she is an accommodation party because the purpose of the loan was to pay for the funeral expenses of Jean's son. Kathy, however, appears to have received receive a direct benefit because Jean used some of the money to pay tax arrearage and insurance on Kathy's home.

If Kathy is an accommodation party, she is entitled to reimbursement for any money that she pays Star Bank, and Jean is not entitle to recover anything from Kathy. 3-419(e).

If Kathy is not an accommodation party, she has a right to contribution to the extent that she pays more than 50% of the note, and Jean has the same right. 3-116(b).

C. What rights and liabilities would Star Bank have if it had issued the check to an impostor, pretending to be Jean?

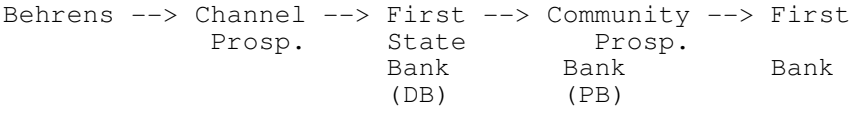
If Star Bank paid an impostor, pretending to be Jean, it would still owe Kathy and Jean the amount of money that it promised to lend them. Kathy and Jean could recover this money in a contract action. In addition, they could assert their claim if Star Bank attempted to enforce the note against them. 3- 305(a)(3).

Star Bank would not have to pay the impostor, but Star Bank would be liable to a person who took the check in good faith and for value from the impostor if the impostor indorse the check in the name of Jean. 3-404(a). This liability would not affect Kathy and Jean's rights. If Star Bank paid someone who took the check from the impostor, Star Bank could recover the money from the impostor under a theory of fraud or restitution.

D. What risks did Kathy and Jean face in executing the note to Star Bank? They both ran the risk that the check would be negotiated to a holder in due course, stripping away any defense that they might have against the bank, such as failure of the consideration if they did not get the money. 3-305(b).
Kathy faced the risk that Jean would not repay the note, and she would be liable to Star Bank for the entire amount. Although Kathy might have a right to contribution or reimbursement from Jean, Jean might lack the funds to pay her.

PROBLEM III.

The edited excerpt comes from Channel Equipment Co., Inc. v. Community State Bank, 996 S.W.2d 374 (Tex. App 1999).



Thu., Oct. 17: checks deposited in First Prosperity Bank
Fri., Oct. 18, 3:00 p.m.: checks presented to Community State Bank Tue., Oct. 22: checks returned to First Prosperity Bank

A. Is Community State Bank accountable for the checks?

A payor bank is accountable for a check if it fails to return the check before its midnight deadline. 4-302(a)(1).

If Community State Bank fixed its cutoff hour for handling items to be prior to 3:00 p.m., then the checks presented at 3:00 p.m. on Friday would be treated as though it were presented on Monday. 4-108(a),(b). Community State Bank's midnight deadline therefore would be Tuesday at midnight. The bank met this deadline by returning the checks during the day on Tuesday, and therefore is not accountable for the checks.

If Community State Bank did not fix its cutoff hour to be prior to 3:00, then its midnight deadline would be on Monday. 4-104(a)(10). The bank would have missed this deadline by returning the checks on Tuesday, and therefore ordinarily would be accountable for the check. But the midnight deadline could be extended if Community State Bank used a highly expeditious method of return that result in their receipt by First

Prosperity Bank the same day. Reg. CC 229.30(c); First Nat'l Bank v. Standard Bank.

Note: Liability also may arise from the notice requirement in Reg. CC 229.33(a).

B. Did Channel have a right to recover payment for the August invoices from Behrens after October 22?

Under the doctrine of merger, the obligations reflected in the August invoices were suspended when Channel took Behrens's checks for them. 3-310(b). The suspension would cease if the checks were dishonored prior to the payor bank's midnight deadline. 3-310(b)(3). (See above.)

C. Under what circumstance would First Prosperity Bank have a duty to give Channel credit for the checks as of October 22?

First Prosperity, the depositary bank, at a minimum had a duty to give Channel Credit $100. Reg. CC 229.10(c)(vii).

If the checks were local checks (which they would be if First Prosperity and Community State were served by the same branch of a Federal Reserve Bank), then First Prosperity had to give credit for the first $5000 of the check by the start of business on Tuesday. Rev. Cc. 229.12(b)(1); 229.13(b).

D. Does anyone have a claim for restitution?

Unless Community State Bank missed its midnight deadline, no one would have a right to restitution. [Note: First Prosperity could recover any credit given for the checks under 4-214(a), but that is not really a claim for restitution.]

If Community State Bank missed its midnight deadline, and paid the checks, then Behrens paid the August invoices twice. Ordinarily, it could recover in restitution for this double payment unless an exception applies. Under the discharge for value exception, it probably cannot recover because it owes Channel other debts. Cf. Banque Worms v. BankAmerica.

Also, if Community State Bank missed its midnight deadline, and paid the checks by mistake, it could recover any payment that has not already been refunded in restitution unless the Price v. Neal exception applies. 3-418(b), (c).

PROBLEM IV.

The edited excerpt comes from Coregis Ins. Co. v. Fleet Nat'l Bank 793 A.2d 254 (Conn. App. 2002).

School Board --> Avants --> ... --> Fleet Nat'l Bank

A. Is the check properly payable?

It is somewhat ambiguous whether the check is payable to Trudy Avants AND Delores Carpenter or instead to EITHER Trudy Avants OR Delores Carpenter. If an instrument is ambiguous as to whether it is payable to two persons alternatively, the instrument is deemed to be payable to them alternatively. 3-110(d)'s last sentence. Accordingly, the check appears to be properly payable to either Trudy Avants or Delores Carpenter alone. 3-110(d)'s first sentences. The check therefore is properly payable on Trudy Avants's indorsement. The forged indorsements are unnecessary for the enforcement of the check and have no effect. 3-403.

If the check were payable to both Trudy Avants AND Delores Carpenter, the check would not be properly payable without Delores Carpenter's indorsement. But the forged indorsement nevertheless might be valid because Delores Carpenter entrusted Trudy Avants with responsibility for handling checks. 3-405(a)(1),(a)(3),(b).

B. Do Joseph Walton and Delores Carpenter have a claim for conversion? A check is converted if possession is wrongfully taken or the check is paid without authority. 3-420(a). Joseph Walton and Delores Carpenter do not have a claim for conversion against Trudy Avants -- whether the check is properly payable or not -- because as their agent she was not in wrongful possession of the instrument.

As explained above, the check appears to be properly payable. But if the check were not properly payable, Joseph Walton and Delores Carpenter would have a claim for conversion against any bank that makes or obtains payment (which may not have occurred yet).

C. To what extent does the school board remain liable?

The check has not yet been paid. The school board is liable on the check to any person entitled to enforce. If the Fleet National Bank pays a person entitled to enforce, it may charge the school board's account. Assuming the settlement agreement allowed the school board to deliver the check to Trudy Avants, the school board suspended its liability under the settlement for the physical injuries by issuing the check. 3-310(b). This suspension of liability on the underlying obligation remains in effect until the check is dishonored. The school board therefore does not have any liability.

D. If Carpenter informs Fleet National Bank what happened, what action should Fleet National Bank take?

Carpenter does not have a right to stop payment. However, Fleet National Bank should consider the risks that it faces if it pays and the risks that it faces if it does not pay the check.

If Fleet National Bank pays the check and the check is properly payable, the bank may charge the school board's account. 4-401(a).

If Fleet National Bank pays the check and it is not properly payable, the bank may recover from Trudy Avants for breach of presentment warranty. 4-208(a)(1). But relying on this remedy is risky; Trudy Avants probably does not have much money if she is stealing funds from clients. (If a depositary bank is involved, then the risks are smaller, because the depositary bank surely has money.)

Fleet National Bank also would face no liability to Trudy Avants if it refuses to pay the check, whether the check is properly payable or not. 3-408. If Fleet National Bank does not pay the check, and the check is properly payable, Fleet National Bank might be liable to the school board for wrongful dishonor 4-402(a). But the school board is unlikely to want any damages given the circumstances. (Perhaps Fleet National Bank could call the school board and ask.)

Accordingly, even though the check appears to be properly payable, the risks of paying the check may be greater than the minimal risks of dishonoring it.

PROBLEM V.

The edited excerpt comes from Moody Nat. Bank v. Texas City Development

Ltd. Co., 44 UCC Rep. Serv.2d 261 (Tex. App. 2001).

TCD ---> Bank of East Asia ---> Moody Bank ---> Stewart Title

A. What are the rights of TCD and Bank of East Asia with respect to each other?

TCD has an obligation to pay the amount of the payment order because Bank of East Asia accepted it by executing a payment order for the purpose of completing the transfer to Stewart Title. 4A-402(b); 4A-209(a)
TCD is not entitled recover under the money back guarantee because payment reached Stewart Title. Cf. 4A-402(c) & (d).

B. May TCD recover from Moody Bank under article 4A or common law?
Moody Bank does not appear to have breached any duties under article 4A because it did transfer the money to Stewart Title. Payment is made if the money reaches the beneficiary's bank.

Most courts have held that article 4A preempts negligent claims in connection with funds transfers. Grain Traders v. Citibank; 4A-102 cmt. But in this case, there was no negligence with regard to the funds transfer itself. Instead, the negligence came later in reporting the status of Stewart Title's balance. But Moody Bank may argue that it owed no duty to TCD.

C. Would it have been less risky for TCD to send the payment to Stewart Title using a check instead of a wire transfer?

The problem here is that TCD and Hoover did not know whether Stewart Title had received the payment. If TCD had paid by check, their subsequent receipt of a canceled check indorsed by Stewart Title would have proved that Stewart Title had received payment.

On the other hand, TCD would have faced other risks if it had sent payment by check. Most significantly, delivery of the check or payment of the check might have been delayed for substantial time. This delay also may have prevented the deal from going through.

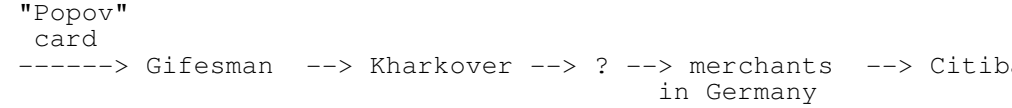
The law governing checks and the law governing funds transfers both provide protection against fraud and forgery.

D. What should TCD have done immediately upon hearing that Moody Bank did not have the funds?

It should have asked for its money back under the money back guarantee (which it would be entitled to receive if the money actually had not been returned). If it had done that, East Asian Bank would have asked for its money back. Moody Bank most would have had to deal with that request more seriously because the intermediary bank that dealt with Moody would have evidence documenting the payment.

PROBLEM VI.

The edited excerpt comes from Citibank (South Dakota), N.A. v. Gifesman, 773 A.2d 993 (Conn. App. 2001).



A. Citibank argued that "the Kharkover stipend, without more, made use of the Popov card an authorized use." Is this argument correct?
If the person who used the card in Germany was Kharkover (or someone else

to whom Gifesman or Kharkover had given permission), then the use was authorized. The stipend is not necessary but it makes clear that Gifesman granted this actual authority. CCPA 103(o).

Even if the person who used the card lacked actual or apparent authority to use the card, Citibank might argue that the use was not unauthorized because Gifesman received a benefit (i.e., the stipend) from such use. CCPA 103(o)'s last clause. But maybe Gifesman could counter that the stipend was only for authorized use and that he received no benefit for unauthorized uses.

B. Gifesman argued that charges were unauthorized because they far exceeded the card's credit limit. Is this argument correct?

Under CCPA 103(o), authorization to use a credit card is not dependent on the credit limit. Therefore, authorization would depend on the contract between the issuer and the cardholder. The issuer may require merchants to bear the risk that a card is overdrawn (see casebook at 215), but usually the issuer reserves the right to charge the cardholder for charges made by the cardholder over the limit.

C. To what extent would negligence by Gifesman affect his liability to Citibank?

If the charges were unauthorized, then he is not liable for more than $50. CCPA 133(a)(1)(B). His negligence is irrelevant. However, some courts say that a person whose negligence permits continued use of a credit card may be estopped to claim that charges were unauthorized. Minskoff v. American Express. The facts do not say whether Gifesman delayed in reporting.

D. If the charges were unauthorized, who bears liability for them?

Gifesman would bear liability only to $50. CCPA 133(a)(1)(B). Citibank would bear the remaining liability, unless it can charge back the amount of the charges to the merchant who accepted the charges. Citibank also would have a claim against whoever used the cards.

PROBLEM VII.

The edited excerpt comes from New Orleans Brass v. Whitney Nat'l Bank, 818 So.2d 1057 (La. App. 2002).

A. What was the Brass's principal protection against the possibility that LSED intentionally would overstate the rent owed?

The principle protection was the expectation that LSED would act truthfully. If the notarized statement was made under penalty of perjury, intentionally overstating the amount owed would be a felony. Intentionally overstating the amount may be a form of criminal bank fraud.

In addition, the Brass also will have a breach of contract claim or restitution claim against LSED if it obtains more than it is owed.

B. If LSED accidently had overstated the rent owed by about $35,000 dollars, what rights would the parties have?

The parties rights and duties under the letter of credit are independent of the lease between the Brass and LSED. 5-103(d). Accordingly, LSED could recover the amount requested from Whitney National Bank, and Whitney National Bank could obtain reimbursement from the Brass. 5-108(a), (i)(1). The Brass would have a claim for restitution or breach of contract against LSED for the amount of the overpayment.

C. If the documents presented by LSED omitted the words "We hereby certify that," what rights would the parties have?

A bank must pay the letter of credit pay only if the presentation strictly complies with the letter of credit. 5-108(a). It would depend on banking usage whether those initial words were required. 5-108(e).

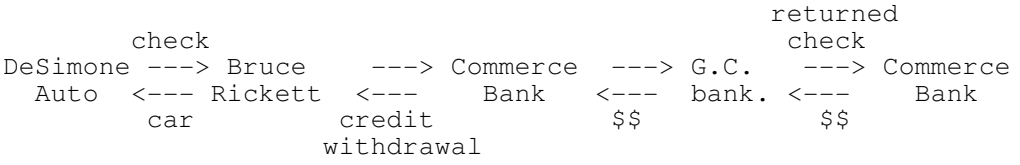
D. Is it accurate to describe a standby letter of a credit as a "guarantee"?

No. A guarantee is a separate legal arrangement. (See casebook at 439-440). If Whitney Bank were merely guaranteeing the Brass's payment, the Bank could assert whatever defense to payment the Brass might have. But under a letter of credit, it may not assert the Brass's defenses. Again, the obligation to pay the letter of credit is independent of the lease. 5-103(d).

December 19, 2000

COMMERCIAL PAPER--PAYMENT SYSTEMS
Final Exam Answer Guide

PROBLEM I.



A. To what extent may Commerce Bank recover from Rickett?

As the depositary bank, Commerce Bank may revoke its settlement and recover the full $12,000 credit given for the check if it did not receive final payment. See 4-214(a). Commerce Bank did not receive final payment if Gloucester County Bank returned the check before its midnight deadline (not 100% certain on these facts, but a reasonable assumption). However, if Commerce Bank failed to notify Rickett that it was revoking the credit by its midnight deadline or a longer reasonable time, it would be liable to Rickett for any damages suffered. See 4-214(a); Essex Construction v. Industrial Bank.

B. To what extent may Commerce Bank recover from DeSimone?

DeSimone is the drawer of the check. If Commerce Bank does not recover from Rickett, it will retain the check. As the holder, it may enforce the check against DeSimone. DeSimone may not assert any defense because Commerce Bank is holder in due course, having taking the check in good faith and without notice of claims and defenses. Commerce Bank gave value because it allowed Rickett to withdraw the money. See 4-211; 4-210(a)(1).

C. If Gloucester County Bank had paid the check, could it recover from DeSimone, Rickett, or Commerce Bank?

If Gloucester County Bank had sufficient time to act on the stop payment order, the payment was unauthorized. See 4-403(a). Accordingly, Gloucester County Bank would not have a right to charge DeSimone's account. See 4-401(a). Gloucester County Bank, however, would be subrogated to Commerce Bank's rights because of the payment, and could assert Commerce Bank's right to enforce the check against DeSimone as a holder in due course. See 4-403 cmt. 7; 4-407.

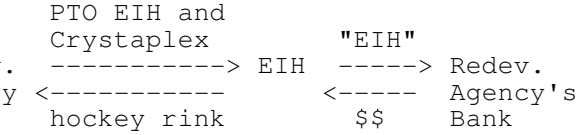
Gloucester County Bank could not recover from Commerce Bank under a theory of restitution because Commerce Bank took the check in good faith and for value. See 3-418(a),(c). It could not recover for breach of presentment warranty because there was no breach. Gloucester County Bank, however, could obtain restitution from Rickett as person "for whose benefit" the check was taken. See 3-418(a). [Note: If Gloucester County Bank did not receive the stop payment order in sufficient time to act on it and Gloucester County Bank missed its midnight deadline for returning the check, it could charge Rickett's account for the check. See 4-403(a); 4-401(a).]

D. What advice would you have given DeSimone and Rickett in setting up this transaction?

DeSimone should not have given Rickett a check when it knew that it might have a defense to payment if the car was damaged because the defense could be stripped away by a holder in due course (like Commerce Bank). Instead,

DeSimone should have put the money in escrow or perhaps paid with a letter of credit requiring Rickett to present some sort of inspection certificate to obtain payment.

PROBLEM II.



A. Why would the Redevelopment Agency issue a check to EIH and Crystaplex when its contract was only with Crystaplex?

The Redevelopment Agency presumably wanted to ensure that Crsytaplex would pay EIH as its subcontractor. The check was payable to both, and thus required both to indorse before the check could be paid. See 3-110(d). Accordingly, EIH could refuse to indorse the check unless Crystaplex paid EIH for its work. This is a common practice.

[Note: This question was asked primarily to give a hint that both EIH and Crystaplex would have to indorse the check to make it properly payable.]

B. What rights does the Redevelopment Agency's bank have against EIH and the Redevelopment Agency?

The bank may not charge the Redevelopment Agency's account because the check was not properly payable to EIH alone. The check was payable to EIH and Crystaplex. See 4-401(a); 3-110(d). No exception applies because the check does not contain any unauthorized signatures.

The bank may recover from EIH for breach of the presentment warranty that it was entitled to enforce. See 3-417(a)(1); 4-208(a)(1).

[Note: The bank also might be able to recover from EIH in restitution, but EIH has an argument that it initially took the check in good faith and for value. See 3-418(a); (c). Recovering for breach of presentment warranty seems less complicated.]

C. Does Crystaplex have a claim against the Redevelopment Agency or its bank based on conversion or any other theory?

Crystaplex has a claim against the Redevelopment Agency for payment under the contract. This claim was not discharged under the doctrine of merger because Crystaplex never took the check. See 3-310(b)(2).

Crystaplex alternatively has a claim against the Redevelopment Agency's bank for conversion because it paid the check to a person not entitled to enforce it without Crystaplex's indorsement. See 3-420(a). The exception that ordinarily prevents a payee who has not received delivery from recovering for conversion in 3-420(a)'s last sentence does not apply if a co-payee received delivery.

D. Would the rights of the parties be different if EIH had forged Crystaplex's indorsement?

Unless an exception applied, nothing would change. The forged indorsement would be treated as the signature of the forger -- EIH -- who already has indorsed. See 3-403(a).

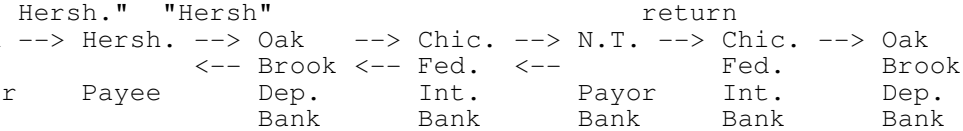
One possible exception: The Redevelopment Agency's bank might argue that

the Redevelopment Agency's was negligent in issuing the check to EIH without notifying Crystaplex. If this negligence substantially contributed to the forged indorsement, the Redevelopment Agency might be precluded from asserting that it was unauthorized. See 3-406(a). Accordingly, the bank could charge the account.

[Note: The exception for employee signatures does not appear to apply. Although an independent contractor may qualify as an entrusted employee, Crystaplex never entrusted EIH with the check. See 3-405(a), (b).]

PROBLEM III.

"Northern Trust
PTO Hersh. $X,
/s/ Hersh." "Hersh" return



deposited: Tue. 2/10
presented: Wed. 2/11
midnight deadline: Thu. 2/12 midnight
notice of dishonor: Fri. 2/13 3:36 p.m.
checks returned: Fri. 2/13 4:46 p.m.

A. To what extent, if at all, was Oak Brook required to credit Hershenhorn's account for the deposited checks?

Oak Brook had to give $100 by the start of business on Wednesday, February 11. See Reg. CC 229.10(c)(vii).

Assuming these were "local checks," Oak Brook had to give Hershenhorn $5000 in credit for the checks deposited on Tuesday, February 12 no later than the start of business on Thursday, February 12. See Reg. CC 229.12(b)(1); 229.13(b). Oak Brook could have waited a reasonable time before giving any additional credit. See Reg. CC 229.13(h)(1).

B. Is Northern Trust accountable for the checks?

If the checks were presented on Wednesday, February 11, then Northern Trust's midnight deadline was Thursday, February 12. When Northern Trust failed to return the checks by that date, it became accountable for them. See 4-301(1)(a).

The midnight deadline would have been extended if Northern Trust had used a method of returning the checks that ordinarily would result in delivery to the receiving bank (in this case, the intermediary bank) before its close of business on Friday. See Reg. CC 229.30(c); First Nat'l Bank v. Standard Bank. But if the checks only arrived at an intermediary bank at 4:46 p.m., a fair assumption is that did not happen. (Note: In the actual case, the court held that the intermediary bank was open 24 hours a day, but this problem doesn't discuss that peculiar fact.)

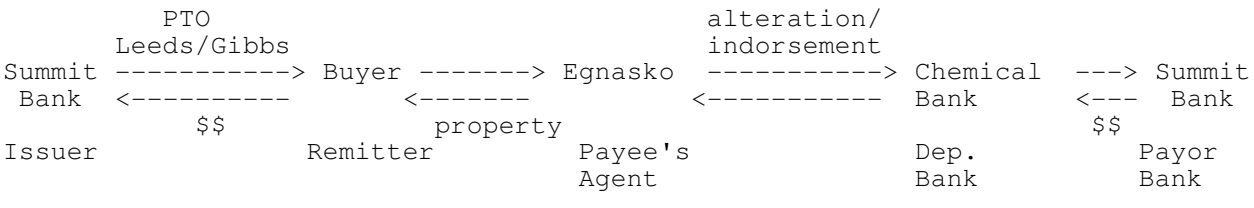
C. May Northern Trust recover under a theory of restitution?
Unless an exception applies, if Northern Trust paid the checks by mistake (e.g., under the incorrect assumption that Hershenhorn had sufficient funds to cover them), it would have a claim in restitution against any person to whom or for whose benefit payment was made (i.e., Hershenhorn and Oak Brook Bank). See 3-418(b); National Savings v. Park Corp.

Oak Brook Bank, however, can assert the Price v. Neal exception at least to the extent of $444,125.76 provided that it took the checks in good faith and for this value. See 3-418(c); 4-211; 4-210(a)(1).

D. What is the likely reason that Northern Trust did not immediately decide to dishonor the checks?

The scheme of check kiting is described in First National Bank v. Standard Bank. Northern Trust probably had given Hershenhorn provisional credit for checks that he had written on his account at Oak Brook and then deposited in Northern Trust. Because of this provisional credit, Northern Trust initially thought that he had enough money in his account to cover the checks presented by Oak Brook. Later, it decided to revoke this provisional credit, causing it to want to return the presented checks.

PROBLEM IV.



A. Do William and Carol Leeds and Isabel Gibbs have any claim against the buyer who paid with the cashier's check?

No. Payment with the cashier's check to their agent completely discharged the buyer's liability on the underlying contract. See 3-310(a).

B. Do the William and Carol Leeds and Isabel Gibbs have any claim against any bank?

Yes. They have a conversion claim against both Chemical Bank and Summit Bank. Chemical Bank took a check for collection from a person not entitled to enforce, and Summit paid the check. See 3-420(a). The exception that ordinarily prevents a payee who has not received delivery from recovering for conversion in 3- 420(a)'s last sentence does not apply if the payee received delivery through an agent.

[Note: The check would be properly payable if the exception for employee forgeries applied, but it does not apply because Egnasko does not appear to have indorsed the instrument in the name of the person to whom the instrument was payable (i.e., Gibbs and the Leeds). See 3-305(b).]

C. What rights do Summit Bank and Chemical Bank have?

Summit Bank may recover from Chemical Bank and Egnasko for breach of the presentment warranty that they were entitled to enforce. See 4-209; 3-417.

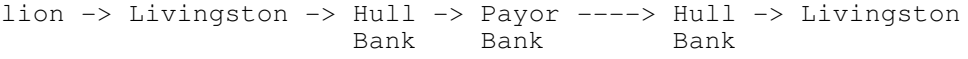
Chemical Bank in turn may recover from Egnasko for breach of the transfer warranty that the check had not been altered. See 3- 416(a)(3).

D. If an impostor pretending to be Egnasko obtained the check from the buyer, forged the payees' indorsements, and deposited the check at Chemical Bank, what would change?
William and Carol Leeds and Isabel Gibbs would have a claim for the purchase price. The buyer would not receive a discharge by giving the check to the wrong person. See 3-310(a).

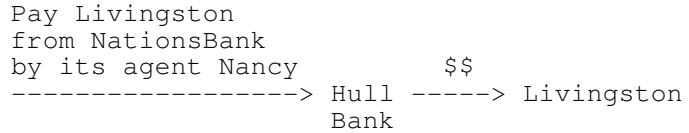
Summit Bank, however, still could recover from Chemical Bank and Egnasko for breach of presentment warranty. The indorsements would not be effective under the impostor rule because the impostor did not obtain the checks from the issuer (i.e. Summit Bank), but from a remitter. See 3-404(a). Summit Bank cannot be responsible for the remitter's failure to check the attorney's identification.

PROBLEM V.

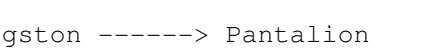
(1) Original Check Transaction



(2) Fraudulent Payment Order



(3) Return of Check in Reliance



A. What rights does Hull Bank have against Livingston?

Hull Bank might attempt to recover the payment based on restitution. Livingston, however, may assert the defense that he relied on payment when he returned Pantalion's check. Cf. Banque Worms. (Note: No provision in article 4A expressly gives the beneficiary's bank the right to seek restitution after executing an unauthorized payment, but 4A-211(c)(2) suggests that such recovery is possible in other contexts).

B. What rights does Livingston have against Pantalion?

Livingston might sue Pantalion on the underlying obligation because he never received payment from Pantalion. Although taking Pantalion's check suspended the underlying obligation, the suspension ceased when the check was dishonored. See 3-310(b)(2). Hull Bank would be subrogated to his recovery if it cannot recover in restitution.

Livingston at this point cannot recover from Pantalion on the check because he is no longer the holder of the check. If Pantalion was involved in Nancy's scheme, Livingston could seek to have the transfer of check rescinded on grounds of fraud, and then sue on check itself. Cf. 3-202.

C. Under what circumstances, if any, might Hull Bank charge NationsBank for the amount of the transfer?

The payment order is unauthorized because NationsBank did not participate in it. The only way a party can be liable for an unauthorized payment order is if it passed a reasonable security procedure agreed to by NationsBank and Hull Bank. See 4A-202(b). In this case, it does not appear that any security procedure was followed.

D. What advice would you give Hull Bank?

It should establish a security procedure for verifying that payment orders

purportedly from NationsBank are really from NationsBank and that its account at NationsBank truly has been credited. For example, they might agree upon a call back procedure or have a password or only accept payment orders sent through Fedwire.

If Hull Bank cannot recover from Livingston in restitution, it might pursue his claims against Pantalion under a theory of subrogation. It also may have fraud claims of its own against Pantalion and "Nancy."

PROBLEM VI.

A. Were the Amtrak charges necessarily unauthorized if Mr. Cheevers did not make them himself? (Give examples.)

No. The tickets would be authorized if someone with actual or apparent authority made them or if he received the benefit of them. See CCPA 103(o). A person would have actual authority if Cheevers gave the person the card and told the person to use it. A person might have apparent authority if Cheevers gave the person the card, but did not tell the person to use it. See textbook, p. 231. If he used the ticket, then he could not say the charges were unauthorized.

The charges would be unauthorized if the person who made them did not have actual, implied, or apparent authority. For example, they would be unauthorized if a thief stole his card.

B. If the charges were unauthorized, could Mr. Cheever be required to pay them based on his failure to notify Crestar?

The orthodox answer is that Cheever's total liability is at most $50. The Consumer Credit Protection Act specifies that a cardholder only is liable for unauthorized charges up to $50. See CCPA 133, 15 U.S.C. 1643. There is no exception for failure to notify the issuer, and a failure to notify the issuer should not convert unauthorized charges into authorized charges. Miskoff v. American Express, however, held that a cardholder's failure to examine card statements provided apparent authority for the charges because it induced a belief in the issuer that the charges were authorized. Mr. Cheever might face liability for the charge under that view (depending on the circumstances). The holding in Miskoff, however, is probably erroneous for the reasons stated in the textbook at p. 231.

C. If Mr. Cheevers was negligent in losing his card and failing to forward his mail, how would that affect his liability?

Again, under the orthodox view, he still would have only $50 in liability. There is no exception in CCPA 133 for negligence.

D. What advice would you give Crestar at this point?

Private contracts may give Crestar the right to charge back the amount of the transactions to Amtrak because they were unauthorized. See Textbook, p. 220, 232. Crestar, however, may have waited to long to assert these rights.
Crestar might try to find the perpetrator of the fraud.

Crestar should have a more effective system of communicating to merchants (or to the services which they use) which accounts it has blocked. If Crestar ever receives a charge from a blocked account, it should reject it. Stop dealing with Cheevers now on the theory that he is likely to cause more losses (or alternatively welcome him back without requiring him to pay on the theory that he will be a loyal customer for life).

PROBLEM VII.

A. What rights does the issuer of the letter of credit have?

The issuer of the letter of credit has the right to reimbursement from Rook because it apparently honored a presentation conforming to the letter of credit. See 5-108(i)(1).

B. What rights does Rook have?

Rook may have a claim against Read for breach of the implied term in the underlying contract that she would not draw on the letter of credit unless it failed to pay the rent. Because of the independence principle, this separate contract remains enforceable. See 5-103(d). (The parol evidence rule, however, may preclude enforcement of this term.)

C. What rights would Read have if the issuer of the letter of credit had refused to pay based on the unstated assumption in the lease?

Read could recover from the issuer for wrongful dishonor. See 5-111(a). She could receive the amount due plus attorney's fees and expenses. See 5-111(e).

D. How would you have advised the parties to phrase the letter of credit?

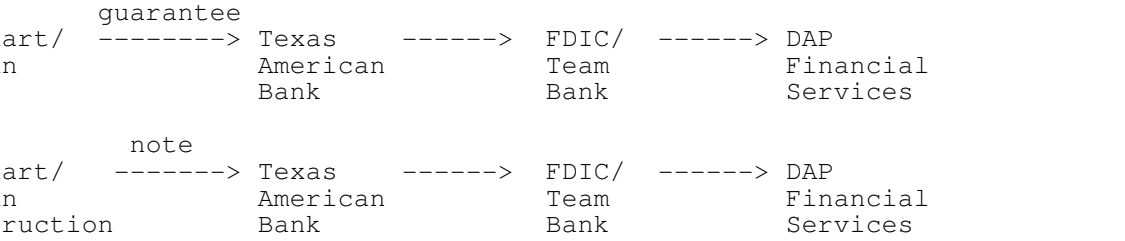
The problem here is that parties did not state all of the necessary requirements in the letter of credit. Rook assumed that Reed would not attempt to collect the letter of credit if Rook paid, but Rook turned out to be wrong. The simplest advice to avoid this problem would be to incorporate the unstated assumption into the letter credit. For example, the letter of credit could have permitting Reed to obtain a payment by presenting a document stating (1) "Rook had failed to renew the letter of credit" and (2) "Rook still owes Reed the amount of the requested payment."

Another possibility would be to eliminate Reed's ability to recover if Rook fails to renew the letter of credit, but give the letter of credit a longer total duration.

December 16, 1999

COMMERCIAL PAPER--PAYMENT SYSTEMS
Final Exam Answer Guide

PROBLEM I.



A. How could Vaughn and Gierhart personally have guaranteed repayment of the note if they had not already made the separate guaranty contract?

They could have signed the note as accommodation co-makers or they could have signed it as anomalous indorsers. They then would have been liable if the company did not pay. See 3-116(a); 3-415(a); Fithian v. Jamar.

B. Assume that Texas American Bank never delivered the $122,500 loan proceeds to the Gierhart/Vaughn Construction Company.

1. What should Gierhart and Vaughn have done immediately?

They should have demanded that the bank return the note so that it did not end up in the hands of a holder in due course. (Ideally, they should not have given the note to the bank before obtaining the loan proceeds.) See Co-Mac v. Kaw Valley Bank.

2. Can DAP recover from the Gierhart/Vaughn Construction Company on the note?

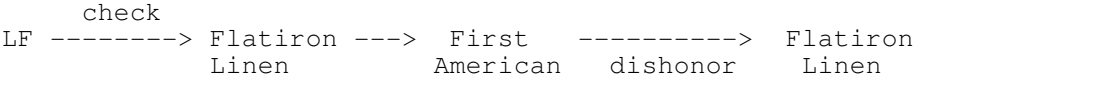
Yes. The FDIC and Team Bank became holders in due course under the FDIC HIDC doctrine when they acquired the note, even though the note was taken in a bulk transfer and after it was overdue. See Campbell Leasing v. FDIC. DAP Financial Services acquired the rights of a holder due course under the shelter doctrine. See 3-203(b). Accordingly, it would not be subject to Gierhart/Vaughn Construction Company's ordinary defense of failure of consideration. See 3-305(b).

3. Can DAP recover from Vaughn and Gierhart personally on the separate guaranty contract?

No. The separate guaranty contract is not a negotiable instrument. Accordingly, the HIDC doctrine does not apply and no defenses are stripped away. Guarantors may assert the defenses of the principal debtor. See Jorden and Warren at 365.

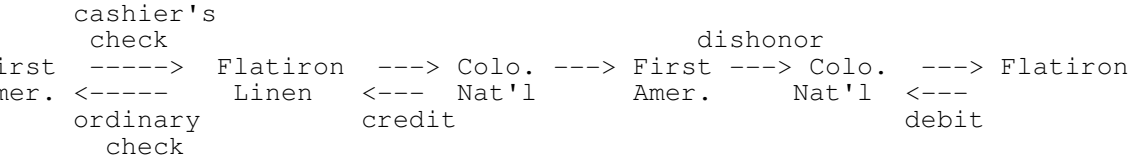
PROBLEM II.

(1) FLF issues any ordinary check that is dishonored and returned.



(2) FLF stops payment on ordinary check.

(3) First American mistakenly pays the FLF's check by issuing a cashier's check, but then refuses to pay the cashier's check.



A. What rights do Flatiron Linen and First American State Bank have against each other?

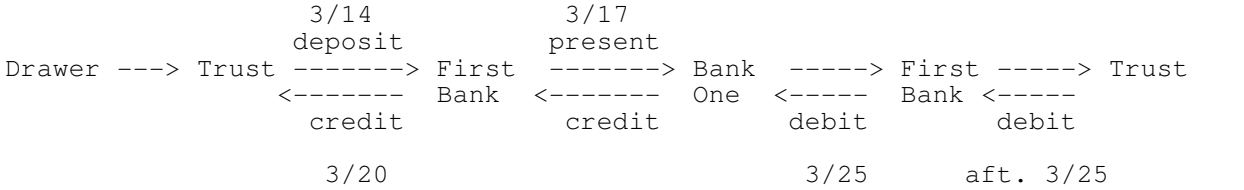
Flatiron Linen is entitled to enforce the cashier's check against First American State Bank and recover damages for wrongful dishonor. See 3-301; 3-411(b).
First American State Bank does not appear to have any defenses because it voluntarily gave the cashier's check as payment.
First American may seek restitution from Flatiron because it mistakenly paid the ordinary check despite a stop payment order. See 3-418(a)(i). Restitution, however, would not be available if Flatiron took the ordinary check from FRF in good faith and for value or changed its position in reliance on the payment. See 3-418(c); Price v. Neal.

B. What rights does Flatiron Linen have against FRF?

If First American State Bank does not obtain restitution, then Flatiron Linen has no rights against FRF because Flatiron Linen already has received payment for the ordinary check.

Note: If First American State Bank does obtain restitution, the instrument will be deemed not to have been paid, and Flatiron may enforce it against FRF or sue on the underlying obligation. See 3-418(d), 3-310(b)(3).
C. What rights does First American State Bank have against FRF?
First American State Bank may not charge FRF's account for the ordinary check because it was not properly payable after the stop payment order. See 4-401. Possibly it could charge a fee for the stop payment order.
Note: First American State Bank, however, may be subrogated to Flat Iron Linen's right to enforce the check agaist FRF after mistakenly paying it contrary to the stop payment order. See 4-403 cmt. 7. First American State Bank, however, would be subject to any defense the FRF might assert.
Note also: This answer assumes that the stop payment order on Oct. 17 was written. If the stop payment order was oral, then it expired in 14 days.
D. If Colorado National Bank had not returned the cashier's check to Flatiron, could it have recovered from First American State Bank?
Yes. It would have been the holder of the cashier's check. See 3-301. As noted above, First American State Bank has no defense to payment.

PROBLEM III.



A. Did FirstBank have a right to charge back the amount of the check?

No. A bank can charge back a customer's account only if it fails to receive a final settlement. See 4-214(a). First Bank received a final settlement. Bank One had no right to return the check after is midnight deadline (March 18). See 4-301(a).

B. If FirstBank had not charged the Trust's account, what rights would it have?

First Bank would have right to refuse the return of the check after passage of the midnight deadline. See 4-301(a).

C. What rights did Bank One have immediately after it paid the check? Bank One had the right to charge the customer's account, even though the charge would create an overdraft. See 4-401(a).

Bank One could have sought restitution from First Bank. See 3-418(b); National Savings v. Park Corp. If First Bank already had given credit to the Trust, however, then restitution would not be available. See 3-418(c); Price v. Neal.

Note: Prior to final payment (i.e., before its midnight deadline), it could have revoked the settlement. See 4-215(a).

D. How would the rights of the parties have differed if the check had contained a forged drawer's signature?

Bank One could not charge the Trust's account because the check would not be properly payable (absent some exception). See 4-401(b).
Bank One could recover from First Bank or the Trust for breach of presentment warranty, if they knew the drawer's signature was unauthorized. See 3-417(a)(3); 4-108(a)(3).

Bank One could recover from the forger of the check as the drawer. See 4-403(a).

First Bank in turn could recover from the Trust for breach of the transfer warranty that all signatures are authorized. See 3-416(a)(1).

PROBLEM IV.

A. Can the tenants' banks charge the tenants' accounts for the stolen rent payment checks?

Yes. A bank may charge a customer's account for an item that is properly payable. See 4-401(a). These checks were properly payable, despite Spaeth's forgery, because of the exception for forged indorsements by employees entrusted with responsibility. See 3-405(b); Merrill Lynch v. Chemical Bank. Spaeth was entrusted with responsibility because she had authority to process items received by the employer. See 3-405(a)(3)(ii).

B. May the tenants or Halla's business recover from anyone under a theory of conversion?

The tenants may not recover under a theory of conversion because they are the issuers of the checks. See 3-420(a)(i).

Halla's business may not recover the banks that paid the checks or took them for collection because they took the checks from a person entitled to enforce them. See 3-420(a)(ii).

Halla's business may be able to recover from Spaeth to the extent her conduct constitutes conversion (as opposed to embezzlement, etc.) under applicable common law.

C. Did anyone breach any warranties?

Yes. Spaeth breached a transfer warranty to Norwest bank that all the signatures on the check were authentic and authorized because Halla's was not. See 3-416(a)(2). This breach, however, probably did not cause any damages because the checks still were properly payable. See 3-416(b). Note: No presentment warrant was breached because Spaeth was entitled to enforce.

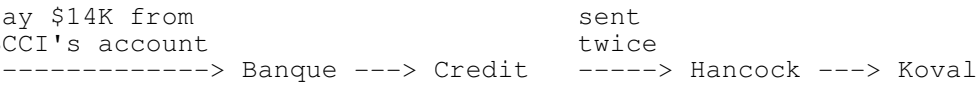
D. Halla argued that "Norwest's practice of taking endorsed checks, originally payable to a business, for deposit into a personal account establishes that Norwest failed to exercise ordinary care." Is this correct and why might it matter?

The argument is not correct. Ordinary care is determined by standard banking practice. See 3-103(a)(7). Depositary banks do not verify all of the indorsements on the checks received for deposit because they have no means to do so. See Merrill Lynch v. Chemical Bank.

The allegation of negligence might matter because the exception for forged indorsement by employees entrusted with responsibility does not apply to the extent that person taking the instrument acted negligently. See 3-405(b).
In addition, a collecting bank has a duty to use ordinary care in presenting items. See 4-202(a).

PROBLEM V.

BCCI owed Koval $86K.



A. May Koval refuse to refund the second payment to Credit Lyonnais?
A receiving bank which executes a duplicate payment order may recover from the beneficiary to the extent allowed by the law governing mistake and restitution. See 4A-303(a). Koval, however, may assert the "discharge for value" exception because BCCI owed him the money represented by the second payment. See Banque Worms v. BankAmerica.

B. Are there circumstances under which Credit Lyonnais could cancel its second payment order, and how would cancellation affect the rights of the parties?

Credit Lyonnais could cancel the payment order if Hancock Bank (the receiving bank) agrees. See 4A-211(c)(1). Hancock Bank instead of Credit Lyonnais then would have the right to recover from Koval under the law governing mistake and restitution. See id.

C. To what extent may Credit Lyonnais recover from Banque or DPS?
Credit Lyonnais may recover $14K from Banque, but only for the first payment order. See 4A-303(a).

Credit Lyonnais may not recover from DPS under article 4A because the originator has no liability to an intermediate bank. (Could it recover under a theory of restitution?)

D. May Banque charge the BCCI account for either payment?
Yes. Banque may charge the BCCI account for the first payment because it accepted and executed DPS's payment order. See 4A-211(a) (acceptance); 4A-402(c) (duty to pay). It may not recover for the second payment.

PROBLEM VI.

```
      Dec. 22-28
      purchases          bill
Davis ----------> Dillard ----> Owens
```

A. Were the charges between December 23 and December 28 authorized?
No. The charges would be authorized only if Davis had actual or apparent authority to make them. See CCPA 103(o). The mere fact that Davis is Owens's spouse does not give her actual authority to incur debts in her husband's name. In Walker Bank & Trust v. Jones, the wives gave their spouses the cards, and thus were estopped to deny that their husband had apparent authority. In this case, however, Dillard issued the card to Davis without a request from Owens.

Note: No credit card should have been issued except in response to a request. See CCPA 132.

B. What is Owens's liability for Davis's purchases between December 23 and December 28?

Owens has no liability because he did not accept the credit card that his wife used. See CCPA 133(a)(1)(A). Note that the $50 exception only applies to accepted cards.

Note: In a community property state, would Owens liable for his wife's debts?

C. Suppose Davis had obtained a bank credit card using similar tactics. If she used the bank credit card at Dillard, how would the rights of the parties be different?

Owens still would have no liability. Dillard probably could force the issuer of the card to pay.

D. What advice would you give Owens?

Owens need not take any action because he faces no liability. To avoid inconvenience, he could instruct his card issuers not to issue additional cards to Davis.

PROBLEM VII.

```
                                  letter
           application           of credit
Hampton    ----------->  Sea    --------->  S.C. Dep't of
County                 Island               Agriculture
Warehouse               Bank

                        warehouse
        cotton          receipts
Farmers ------> Hampton ---------> mills
                County
```

Warehouse

A. Does Sea Island Bank have to honor the sight draft regardless of whether the allegations are true?

On the basis of the facts given, Sea Island Bank does not have to honor the sight draft because the presentation does not satisfy the letter of credit on its face. See 5-108(a). The affidavit alleges wrongdoing, but does not state that Hampton "has failed to perform the duties and obligations of a licensed state warehouseman." The bank cannot be responsible for knowing whether the allegations constitute a violation of Hampton's duties and responsibilities.

If the affidavit did state that Hampton had violated the rights and duties of a warehouseman, then it would not matter whether the allegations were true or false.

B. If Sea Island Bank honors the sight draft, what rights will it have?

If Sea Island Bank properly honors the sight draft, it will have a right to reimbursement from Hampton. See 5-108(i)(1).

If Sea Island Bank improperly honors the sight draft, it cannot seek reimbursement from Hampton. However, the bank may be able to recover the payment from the South Carolina Department of Agricultural under the law governing mistake and restitution.

C. What are the rights of the mills that purchased the warehouse receipts?

If the mills purchased the warehouse receipts through a due negotiation, they own the receipts and the cotton. See 7-7-502(1)(a) & (b). They can force the warehouse to deliver the cotton, see 7-403(1), or pay damages if they are not received, see 7-203. They also can negotiate the receipts.

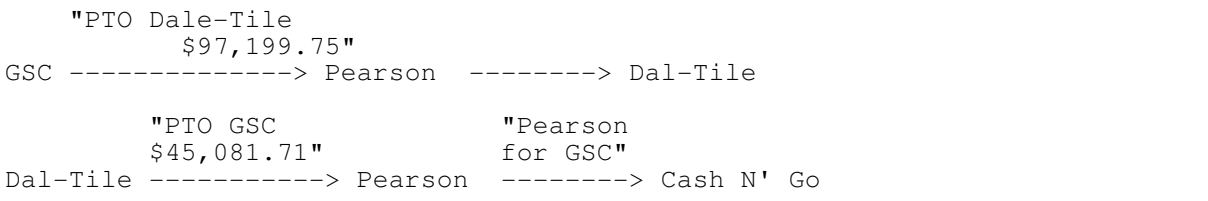
D. What are the rights of the farmers who stored cotton in the warehouse?

The farmers have a right to a warehouse receipt issued to them as part of their contract with Hampton.

May 13, 1999

COMMERCIAL PAPER--PAYMENT SYSTEMS
Final Examination Answer Guide

PROBLEM I.



A. What rights does Cash N' Go have?

Cash N' Go is the holder of the $45,081.71 check and may enforce it against Dale-Tile as the maker or Pearson as the indorser. See 3-414(b); 3-415(a).

Cash N' Go appears to be a holder in due course because it apparently took the check in good faith, without notice of claims or defenses, and -- I assume -- gave value for the check by cashing it. See 3-302(a). As a result, Cash N' Go took the check free of defenses. See 3-305(b). Note: The stop payment order does not affect Cash N' Go's right to enforce the check. See 4-403 cmt. 7 (second half).

B. What rights does Dal-Tile have?

Dale-Tile is the holder of the $97,199.75 check issued by GSC and therefore may enforce GSC. See 3-301; 1-201(20).

GSC, however, may raise the defense of fraud unless Dale-Tile is a holder in due course. See 3-305(b). Dal-Tile took the check for value, namely, the $45K check and the extinguishing of the previous debt owed by Dale-Tile. See 3-303(a)(3) & (4). Dale-Tile did not have notice of any claims and defenses. Blake may argue that Dal-Tile did not act in good faith when Dale-Tile issued the $45K check to GSC. Good faith means honesty in fact and the observance of reasonable commercial standards of fair dealing. See 3-103(a)(4). Blake may contend that Dale-Tile should have made the check payable to Blake, because Blake had issued a check for more than what Dale-Tile
was owed.

Note: Dale-Tile probably cannot recover from Pearson or GSC under a theory of fraud or restitution if it is able to enforce the check because it will not have suffered any loss.

C. Could Pearson have negotiated the $97,199.75 check to someone other than Dale-Tile?

Yes. Ordinarily a check payable to an identified person can be negotiated only to that person. In this case, however, Pearson was an "employee with responsibility" with respect to the checks. As a result, so long as he indorsed the check in the name of Dal-Tile, the indorsement would be effective. See 3-406(b); Merrill Lynch v. Chemical Bank. An "employee" is defined to include the employee of an independent contractor. See 3-405(a)(1).

Pearson is an employee of GSC, which is an independent contractor for Blake Construction. Responsibility includes responsibility for supplying

information to determine the names of payees and to control disposition of instruments issued by the employer. See 3-405(a)(3)(iii) & (iv).

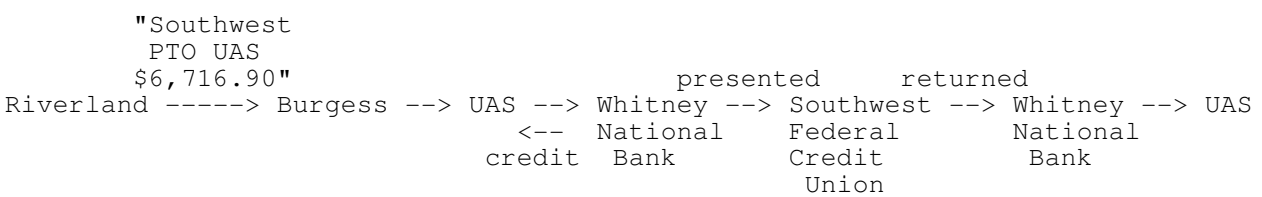
D. May Blake Construction recover from anyone under a theory of conversion or any other theory?

Blake Construction may not recover under a theory of conversion because it is the issuer of the $ 97,199.75 check. See 3-420(a)(i).
Black Construction may recover from Pearson/GSC the cost of any tiles that Blake purchase from them.

Blake Construction may recover $45,081 from Pearson/GSC under a theory of unjust enrichment or fraud.

Note: Blake Construction cannot recover from Dal-Tile in restitution because Dale-Tile acted in reliance on the payment. See 3-418(c).

PROBLEM II.



A. What rights does UAS have against Burgess?

None. Burgess discharged the underlying obligation to pay for the car when UAS took the teller's check. See 3-310(a). As a remitter, moreover, Burgess presumably did not indorse the teller's check, and therefore did not incur an obligation to pay the instrument upon its dishonor.

B. What advice would you have given Riverland Credit Union?

Riverland Credit Union should not have stopped payment on the check. It would not have a right to assert Burgess's defense of non-delivery of the vehicle, even if it was valid. See 3-305(c). Moreover, Riverland Credit Union faces liability for expenses, loss of interest, and possibly consequential damages for wrongfully stopping payment on the cashier's check. See 3-411(b).

C. What obligation did Whitney National Bank have to give credit available for withdrawal to UAS for the check?

Whitney National Bank had to give UAS credit for the first $5000 of the teller's check "not later than business day after the banking day" on which the check was deposited. See 12 C.F.R. 229.10(c)(v) (next day availability); 229.13(b) (exception for deposits over $5000). It would have had an obligation to give UAS credit for the remaining 1,716,90 in a reasonable time. See 4-215(e)(1). It could revoke the credit once payment was stopped. See 4-215(a).

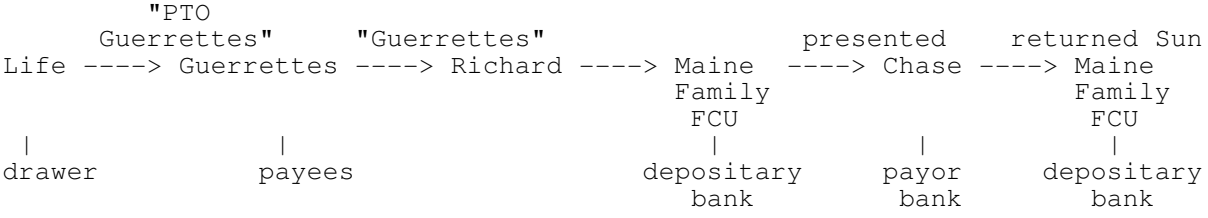
D. If Southwest Federal Credit Union had paid the check, could it recover from anyone?

Southwest Federal Credit Union could recover from Riverland Credit Union. Usually a drawee bank cannot charge a customer's account for a check when payment has been stopped because the check is not properly payable, and indeed the bank may be liable for ignoring a stop payment order. See 4-403(c).

Southwest Federal Credit Union, however, would be the holder of the check and thus could enforce it against Riverland Federal Credit Union. See 4-403 cmt. 7 (drawee may enforce the check); 3-418(d); 3-414(b). Riverside Federal Credit Union has no defense to payment and cannot assert anyone else's defenses. See 3-305(c).

Southwest Federal Credit Union could have revoked payment prior to its midnight deadline and recovered from Whitney National Bank. See 4-301. If it missed its deadline, it probably cannot recover in restitution because UAS and Whitney changed position in reliance on the payment. See 3-418(c). As noted above, Burgess has no liability on the instrument.

PROBLEM III.



A. Under what circumstances would the Guerrettes have a right to recover possession of the checks?

None. Chase returned (or will return) the dishonored checks to Maine Family Federal Credit Union upon dishonoring them. The Guerrettes cannot recover them from Maine Family FCU because it appears to be a holder in due course and thus took free of competing claims of ownership. See 3-306. Maine Family FCU appears to have acted in good faith and without notice, and it took for value because it gave credit for the check which was subsequently withdrawn. See 4-211; 4-210(a)(1). Thus, even if the Guerettes could rescind their negotiation to Richard, see 3-202, they could not recover the checks.

B. Would the Guerrettes have a claim against Sun Life if Sun Life had allowed Chase Manhattan to pay the check?

No. Sun Life is the drawer of the checks and has no duty to order the drawee to stop payment. The payment of checks discharges the drawer even if the drawer knows that someone else has a claim to the instrument. See 3-602(a).

C. What rights does the Maine Family Federal Credit Union have?

Maine Family may recover from Richard the credit that it granted to him because it failed to receive a final settlement for the checks. See 4-214(a). It also could recover from him for breach of transfer warranty. (See below)

Once the checks are returned, Maine Family may enforce them against Sun Life. Maine Family is not subject to defenses if it is a holder in due course. See 3-305(b). (See above)

Maine Family also may enforce the checks against Guerrettes because they indorsed them. See 3-415(a). The Guerrettes also cannot assert any defenses to payment if Maine Family is a holder in due course.

Maine Family could recover from Chase if Chase missed its midnight deadline, see 4-301(a), or failed to return the checks in an expeditious manner, see Reg. CC. The facts suggest this possibility because it took six days for return of the checks.

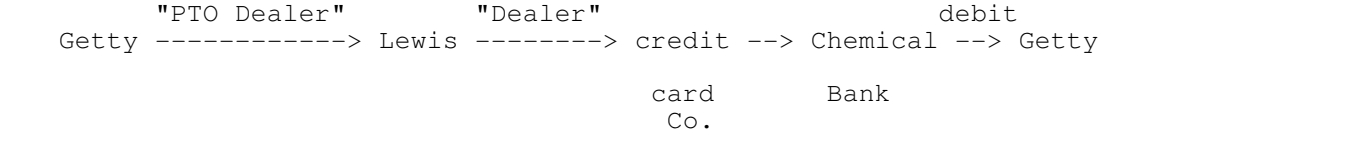
D. Can anyone recover for breach of warranty?

Richard breached the transfer warranty to the Maine Federal Credit Union that there were no defenses that could be asserted against the warrantor. See 3-416(a)(3). The Guerrettes could have raised the defense of fraud if Richard had sued them on their indorsement.

The Maine Federal Credit Union may recover damages equal to the amount of the loss suffered from the breach. See 3-416(b); 4-207. Arguable, the Credit Union has not suffered any loss because, as a holder in due course, it takes free of the Guerrettes' defenses. See 3-305(b).

No one has breached a presentment warranty because the Guerrettes, Richard, and the Credit Union all were entitled to enforce, the instrument has not been altered, and the drawer's signatures has not
been forged. See 3-417(a).

PROBLEM IV.



A. Under what theories, if any, may Chemical Bank charge Getty's account for the checks?

A bank ordinary cannot charge a customer's account for a check which is not properly payable. See 4-401. Getty would argue that these checks therefore were not properly payable to Lewis.

One exception permitting payment is negligence that substantially contributes to the making of a forgery. See 3-406(a). Getty should not have given Lewis sole responsibility for voiding checks. It also should have institute measures to catch the fraud more quickly.

A second exception permitting payment would be forgery by a responsible employee. See 3-405(b). Lewis was entrusted with responsibility for disposition of the checks. See 3-405(a)(3)(v).

A third exception permitting payment is for failure to report forgeries by the same wrongdoer within a reasonable time after receiving the canceled check or statement. See 4-406(d)(2). Does this exception apply? The answer is uncertain. Although the drawer's signature was not forged, the Fchecks were not supposed to be issued. If it did apply, Getty would be responsible for many of checks after April 1991.

B. Is Lewis liable for conversion of the checks?

No. An action for conversion cannot be brought by the issuer of a check or the payee of the check who did not receive it. See 3-420(a).

C. Suppose Getty is looking for a safer way to accomplish the same objectives as its present system.

1. What would be wrong with delivering all checks and having dealers void and return them to get credit?

First, the process would be risky for the dealers. Under the doctrine of merger, by taking and then voiding the checks, the dealers would be extinguishing both the underlying debt owed by Getty and their rights on the checks by voiding and returning them. See 3-310(b)(3); 3-604(a). Second, the process would take much longer than the current system. The

checks would have to be mailed to the dealers and then back again.
2. What better alternative would you suggest?

There are several alternatives: (1) Getty could simply not produce the additional checks in the first place; (2) Getty could hire someone to supervise the person in charge of voiding checks; (3) Getty could send to the bank a list to checks for which credit was given with instructions not to pay them.

PROBLEM V.

```
Corfan ----> Swiss ----> Ocean -----> Silva
             Bank        Bank        Bank
```

A. Should Corfan Bank have assumed the first order was accepted when Ocean Bank sent no notice of rejection?

No. Ordinarily, acceptance at the beneficiary's bank is automatic. See 4A-209; 4A-210 cmt. 2. But when there is a discrepancy between the name and account number, no acceptance can occur unless the exception in 4A-207 applies. See 4A-207(a). Corfan Bank did not have enough information to know whether the exception applied; it only knew that the account number was wrong.

B. Does Swiss Bank have to refund money to Corfan Bank?

Yes. Under a literal reading of 4A-207(a) & (b), no acceptance of the first payment order occurred because the account number was nonexistent (i.e., it did not refer to another account). Under the money back guarantee provisions, the obligations of all senders to pay is excused if there is no acceptance by the beneficiary's bank, see 4A-402(c), and all payment made must be refunded, see 4A-402(d). Swiss Bank therefore must refund the first payment order.

Note: The dissent in this case had a different view. It did not read 4A-207(a) & (b) so literally, and would have held that acceptance had occurred.

C. Who may recover from Silva and on what theory?

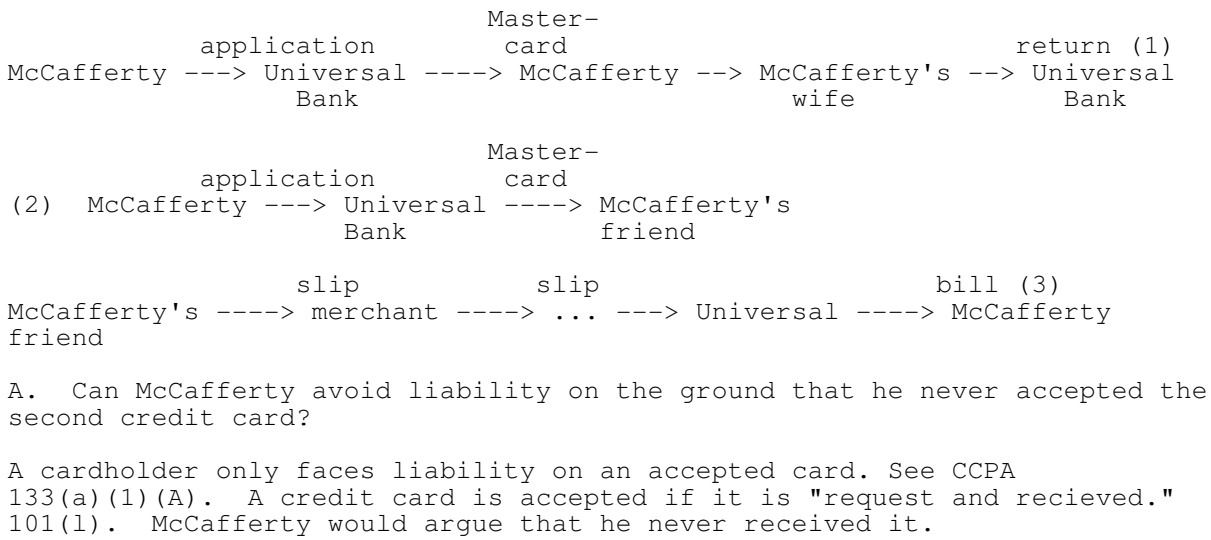
If no acceptance of the payment order occurred (see above), Ocean Bank should be able to recover from Silva on a theory of restitution. Silva would be unjustly enriched by the mistaken payment. Silva may be able to raise a defense, such as reliance on the payment or discharge for value.

D. If Silva is unable to repay the money, can any bank recover from another bank on a theory of negligence?

Ocean Bank may claim that Corfan Bank acted negligently when it incorrectly stated Silva's account number in the first payment order. If this error had not occurred, then Ocean Bank would not have given Silva the money. In addition, it should have explained that the second payment order was a correction.

Corfan Bank, however, will have at least two defenses. First, Ocean bank could have avoided the loss. Cf. Evra Corp. v. Swiss Bank. Ocean Bank should not have paid Silva because acceptance of the payment order could not occur. See 4A-207(a). In addition, Ocean Bank should have communicated with Corfan Bank to clarify the situation. Second, article 4A may preempt a cause of action for negligence. See 4A-102 & cmt. This issue remains undecided.

PROBLEM VI.



A. Can McCafferty avoid liability on the ground that he never accepted the second credit card?

A cardholder only faces liability on an accepted card. See CCPA 133(a)(1)(A). A credit card is accepted if it is "request and recieved." 101(l). McCafferty would argue that he never received it. Universal may argued that his friend's receipt should count because McCafferty's gave Universal his friend's address.

B. Would you have advised McCafferty to tell Universal that he would pay for his friend's charges?

No. Even if McCafferty had accepted the credit card, he would have no duty to pay for more than $50 of the charges because they were unauthorized. See 133(a)(1)(B); 103(o). The statement might be construed as a "ratification" -- or retroactive authorization -- of the charges. See 103(a).

C. Suppose McCafferty had accepted the second card and had allowed his friend use it to make one $300 purchase. What would his liability for the other charges be?

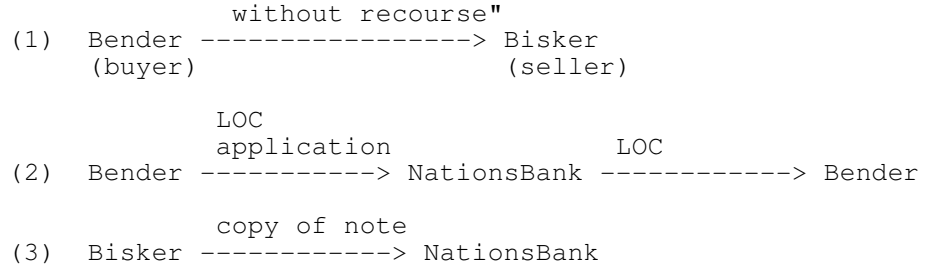
McCarthy would argue that his liability would be limited to $50 because the other purchases were unauthorized. But the Walker case suggests that he would be liable for all of the charges.

D. What steps could Universal and McCafferty's wife take to prevent similar occurrences in the future?

Universal should require cardholders to call them upon receiving credit card. If Universal does not hear from them, it should contact them immediately and cancel the credit card.

Perhaps McCafferty's wife should have told Universal not to issue new cards. She would have little means of preventing her husband from order cards form other issuers.

PROBLEM VII.



```
            signed copy
              of note
(4)  Bender ------------> Bisker

             signed copy
              of note
(5)  Bisker -----------> NationsBank
```

Note: I assume this last step occurred

A. Did NationsBank have a duty to pay the letter of credit based on the first or second presentation?

NationsBank had a duty to pay only if, as determined by standard practice, the presentation appeared on its face strictly to comply with the letter of credit. See 5-108(a). NationsBank will argue that a photocopy is not an original. Expert witnesses could testify about standard practice of financial institutions in the area. See 5-108(e).

Note: An issuer may disregard an attempt by the applicant to waive strict compliance. See 5-108 cmt. 1, 2.

B. What risk would NationsBank face if it had paid the note on an improper presentation?

NationsBank would face the risk that it could not charge Bender. The applicant only has a duty to pay if the issuer has honored a presentation "as permitted" by article 5. See 5-108(i)(1).

C. What advice would you have given Bender when Bisker asked him to sign the photocopy of the note?

Signing would not do any good because the letter of credit called for an original. In addition, it generally not a good idea to sign a second copy of a note. A holder in due course that acquires the original note could enforce the note, and would not be subject to the defense of lack of consideration. See 3-305(c). In this case, however, it would not matter to Bisker because the notes were made without recourse.

D. Does Bisker have a claim against Bender?

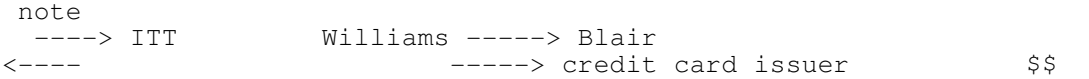
Yes. Bender breached his promise to provide a note to Bisker in exchange for the stock. Bisker can sue him for breach of contract. The doctrine of merger does not apply because Bisker never received the actual note. He does not have a claim on the note because it was signed without recourse.

December 18, 1997

COMMERCIAL PAPER--PAYMENT SYSTEMS
Final Examination Answer Guide

PROBLEM I.

Williams v. ITT Financial Services



A. To what extent, if any, might ITT recover from Williams?
ITT may recover from Williams the portion of the loan used to pay off her credit card debt.

ITT probably cannot recover the balance of the loan from Williams because Williams probably can assert against ITT the breach of contract claim that she has against Blair. Williams probably can assert the breach of contract claim against ITT for three reasons.

First, the note would should have included this FTC "purchase money loan" legend because Williams is a consumer and Blair referred her and other consumers to ITT. See id. 433.1(d), 4.333.2(b).

Second, her jurisdiction may have adopted the Uniform Commercial Credit Code (UCCC). Under the UCCC, ITT would be subject to the breach of contract claim if it conditioned the loan upon her purchase of services from Blair and knew of substantial complaints about Blair from other buyers. See U.C.C.C. 3.405(1)(e), (f).

Third, even if the note does not contain the legend and the U.C.C.C. does not apply, a court might conclude that ITT had such a close connection to Blair that it was a party to the construction contract. See Unico v. Owen.
B. Under what circumstances might ITT recover from Blair?

ITT probably cannot recover on the note from Blair unless Blair, for accommodation, signed the note as an indorser or co-maker. See 3-412, 3-415.
ITT might recover from Blair under a theory of subrogation. ITT most likely would be subrogated to Williams's contract claim, under non-U.C.C. law, if Williams successfully asserts the claim against ITT.

C. If ITT sells the note without disclosing the default, what rights might the purchaser have?

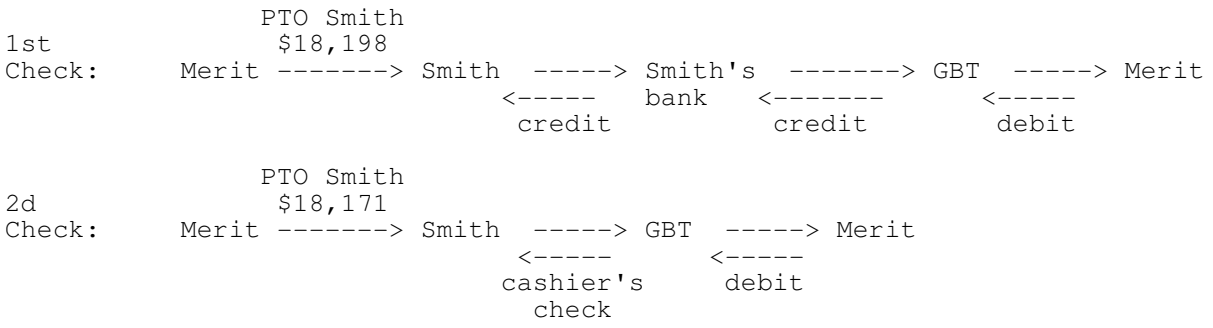
Purchaser v. Williams. The purchaser be entitled to enforce the note against Williams. If the purchaser had the rights of a holder in due course (HIDC), Williams could not assert defenses against him. See 3-302(c). But the purchase is likely to be subject to the defenses because of the FTC purchase money loan legend or the U.C.C.C. See 16 C.F.R. 433.b; U.C.C.C. 3.404(1).

Purchaser v. ITT. If the purchaser cannot recover from Williams, the purchaser might be able to rescind the sale on the basis of fraud. See 3-202(b).
If so, the purchaser could get its money back from ITT.

If Williams has a defense to payment, the purchaser might have a claim against ITT for breach of transfer warranty. See 3-416(a)(4). It also could recover based on an indorsement by ITT. See 3-415(a).

D. Might Williams have arranged to pay Blair in a safer manner?
Yes. Williams should not have agreed to pay Blair in full before he did any work. She could arranged to pay more safely in several ways:
First, she could have put a clause in the note saying that the note would not be transferred, that it was not negotiable, or that her duty to pay was conditioned on satisfactory completion by Blair.
Second, she could have put the loan money in escrow and instructed the escrow agent to pay Blair only upon his satisfactory completion.
Third, she could have used the loan money to obtain a standby letter of credit. The letter of credit would permit Blair to obtain payment only upon presenting an affidavit by a neutral third-party that Blair had done the work.
Fourth, she might have paid the money to her credit card issuer, and then charged the price of the work. She then could assert against the bank her claims against Blair. See CCPA 170.

PROBLEM II.



A. Under what circumstances, if any, would Smith have a duty to reimburse GBT for the first check?

GBT may recover in restitution from Smith if it mistakenly paid the first check despite the stop payment order, unless Smith may assert an exception. See 3-418(a).

Smith probably can assert the Price v. Neal exception because he appears to have taken the check in good faith (provided that he did not know of the mistake) and for value. See 3-418(c).

Smith also might be able to assert the discharge for value exception because he claims that Merit still owes him more money. See Banque Worms v. BankAmerica.

B. May GBT refuse to pay the cashier's check?

No. GBT has no defense to payment. GBT received consideration for the cashier's check; it issued the check in exchange for Merit's second check, which allowed GBT to charge Merit's account. See 4-401(a).
C. To what extent may GBT charge Merit's account?

GBT may charge Merit's account for the first check only if Merit failed to give GBT a reasonable time to act on the stop payment order or Merit waived its rights in issuing the stop payment order. See 4-403(1). The facts suggest that GBT had enough time, and Merit did not sign a waiver.
GBT may charge Merit's account for the second check because it was authorized and not stopped, and thus properly payable. See 4-401(a).
D. What advice would you have given Merit?

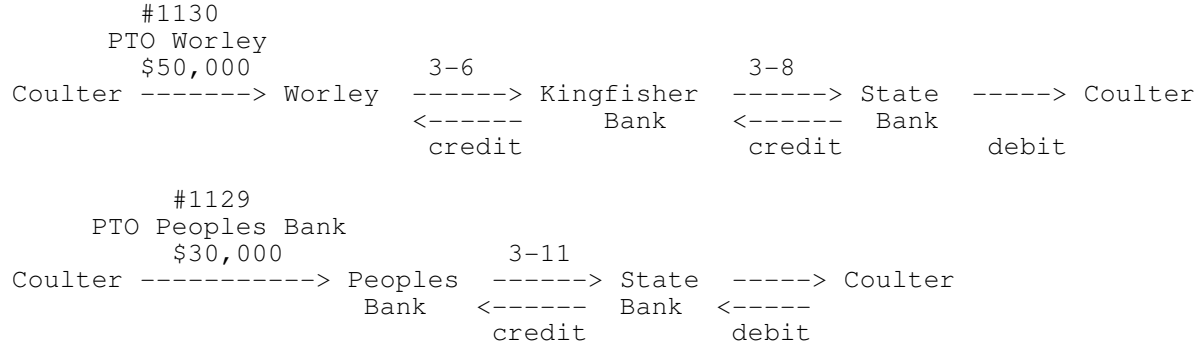
First, Merit should be careful not to make clerical errors when issuing

large checks.

Second, Merit should not have stopped payment on the first check merely because it was for $16.25 too much. A stop payment order usually costs more than that.

Third, Merit should not have issued a second check until Smith surrendered the first check. A check remains enforceable even after the drawer has stopped payment.

PROBLEM III.



A. Should State Bank have reversed the debits and credited Coulter's account?

State Bank had right to debit Coulter's account because the checks were properly payable. See 4-401(a). State Bank should reverse the debits only if Peoples Bank and Kingfisher Bank return the payment that they received from the two checks.

Peoples Bank and Kingfisher Bank, however, have no duty to return the payment. State Bank does not have a right to return the checks because it missed its midnight deadline. See 3-302(a)(1). State Bank also most likely does not have a right to recover the payments in restitution because the Kingfisher Bank and Peoples Bank probably took the checks in good faith and for value, and State Bank did not pay them by mistake. See 3-418(b),(c).

B. When, if at all, did Kingfisher Bank have to give Worley credit for check 1129?

Assuming that Kingfisher and State Bank are "local banks," Kingfisher Bank had to give Worley credit for the first $5,000 by the start of the second business day after the day of deposit, or March 8. See Reg. CC., 12 C.F.R. 229.13(b)(1).

Kingfisher Bank had to give Worley credit for the remaining $45,000 after a reasonable time. See 12 C.F.R. 229.13(h), ; 3-215(e).

C. Can Kingfisher Bank revoke any credit given to Worley?

No. The depositary bank only has a right to revoke the credit given to the depositor if the check is returned before payment has become final. See 4-214(a). Payment already had become final on both checks because, as noted above, State Bank missed its midnight deadline. See 3-301(a).

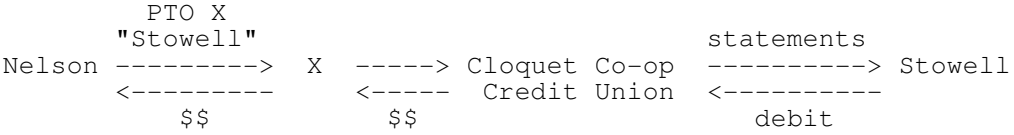
D. May Peoples Bank now enforce check 1129 against Coulter?

Probably not. Final payment of check discharges the drawer's obligation. See 3-602(a). In this case, State Bank made final payment when it failed to return the checks by its midnight deadline. See 3-301(a). It does not appear that State Bank may recover from Peoples Bank under a theory of restitution for the reasons stated above.

If State Bank could recover in restitution from Peoples Bank, then the instrument would be deemed not to have been paid. See 3-418(c). In that unlikely case, Coulter would not be discharged, and State Bank could enforce the instrument against him. See id.

PROBLEM IV.

X = local banks & businesses



A. To what extent may Stowell recover from the Credit Union?
The Credit Union may charge Stowell's account only for checks that are properly payable. See 4-401(a). Forged checks ordinarily are not properly payable because they are not authorized. See 4-401(a).

Negligence Exception. The Credit Union will argue that Stowell is precluded from asserting that the checks were unauthorized because Stowell was negligent in allow Nelson to steal his checkbook and failing to detect the forgeries, and this negligence substantially contributed to the making of the forgeries. See 3-406(a). Stowell, however, may respond that he was not negligent because he exercised ordinary care both in keeping his checkbook and in attempting to track down the missing statements.

Reporting Delay Exception. The Credit Union alternatively may contend that Stowell is precluded from asserting some the forgeries because he did not promptly report the forgeries to the bank. The Credit Union would seek to preclude Stowell from asserting all of the forgeries paid a reasonable time (not exceeding 30 days) after the first statement containing unauthorized payments was sent to him. See 4-406(c).

Stowell cannot escape the preclusion by arguing that he never received the statements. The preclusion applies so long as the Credit Union sends the statements, which it did. See 4-406(c). Stowell, however, may contend that the bank should share the liability because it did not exercise ordinary care when it continued to send the statements even though Stowell said they were not arriving. See 4-406(e).

B. Are the banks and businesses that cashed the checks liable for conversion, breach of warranty, or anything else?

Presentment Warranties. The banks and businesses that cashed the checks did not breach any presentment warranties to the Credit Union unless they knew that the Stowell's signature was forged. See 3-417(a)(3).
Transfer Warranties. Even if the banks and businesses made transfer warranties, no one suffered any damages because the Credit Union paid the checks. See 3-416(b).

Conversion. The banks and businesses did not convert the checks because they were entitled to enforce them. See 3-420.

Restitution. The banks and businesses are not liable in restitution, provided that they cashed the checks in good faith. See 3-418(c).
Indorser Liability. The banks and businesses do not face indorser liability because the checks were paid. See 3-415(a).

C. What is Nelson's liability in connection with the checks?
Nelson's liability on the checks was discharged when the Credit Union paid

them. See 3-602(a). The Credit Union may charge Nelson for the accounts to the extent that it may not charge Stowell under a theory of restitution or perhaps 4-401(a). Stowell may recover his losses from Nelson under a theory of fraud.

D. How should Stowell have protected himself in this situation?
First, Stowell should have taken measures to prevent the theft of his checkbook.

Second, Stowell should have examined his checkbook to see whether any checks were missing.

Third, Stowell should not have ask the Credit Union to send mail to an unsecured mailbox.

Fourth, Stowell should have gone to the Credit Union to obtain a statement when he could not get one through the mail.

PROBLEM V.

	Homeside's		Community	Stevens
Homeside	Bank		Bank	Financial
originator -->	originator's bank -->	intermed. bank -->	beneficiary's bank -->	beneficiary

A. Under what circumstances, if any, could Homeside have canceled the mistaken payment order?

Homeside could have canceled the payment order if it had communicated its desire to cancel to the receiving bank "in a manner affording the receiving bank a reasonable opportunity to act on the communication before the bank accept[ed] the payment order." See 4A-211(b).

After acceptance, Homeside could cancel only if all of the receiving banks agreed to the cancellation of the orders that they had received. See 4A-211(c). That result seems unlikely because Community Bank does not want to cancel.

Note: Community Bank does not have a right to agree to a cancellation because Stevens Financial was entitled to receive payment from Homeside. See 4A-211(c)(2)(ii). Stevens Financial, however, could waive this protection.
B. Absent cancellation, does Homeside have claims against any receiving bank?

Homeside has no claim against any receiving bank under article 4A because the funds transfer was completed. See 4A-402(d). (Homeside might have a restitution claim against Stevens Financial, see 4A-303(c), but Stevens Financial is not a receiving bank.)

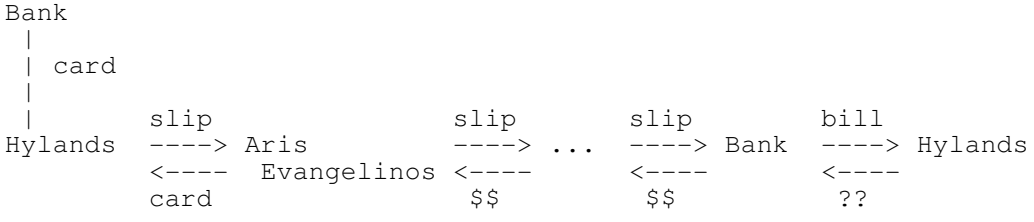
Note: Homeside arguably should have a right to obtain the 1995 Note from Community bank because Homeside paid the bank for it.
C. What rights does Homeside have against Stevens Financial?
Homeside now has sent Stevens Financial $489,466. Homeside should have a right either to (1) restitution of the money, see 4A-303(c), or (2) delivery of the mortgage pursuant to the contract. Stevens Financial, however, may have a claim for damages because Homeside sent the money to the wrong place.
Note: If Homeside obtains the note from Community Bank, it can enforce the note against Stevens Financial. It could recover $125,274.95 unless Stevens Financial has a defense.

D. If Homeside had agreed to pay Stevens Financial by check, how would the risks have been different?

If Homeside had agreed to pay by check, it could have given the check directly to Stevens Financial. Stevens Financial then could decide where to deposit the money. If Homeside mailed the check to the bank by mistake, the check would not be properly payable.

There would be a risk that the check would bounce, but that is not a major risk because Stevens Financial did not transfer the mortgage until it received payment.

PROBLEM VI.



A. What, if anything, may the bank recover from the Hylands?
The Bank will want to recover the full purchase price of the carpet. The Hymans do not have a statutory right to assert, against the Bank, the warranty claim that they have against Evangelinos because the transaction took place more than 100 miles from home. See CCPA 170.

A court, however, might find that an implied contractual duty on the part of the bank to accept the defense because the Hymans relied on its advice and returned the carpet.

B. What concerns, if any, should Evangelinos now have?

As a practical matter, neither the Bank nor the Hylands will want to sue Evangelinos because the cost would be too great.

Evangelinos may worry that the Bank will "charge back" the amount of the carpet. He then would have to sue the Hylands for the price. See Jordan & Warren, at 229.

Evangelinos also may worry that the Bank will ask to have Evangelinos's VISA privileges suspended.

C. Would your previous answers change if the purchase of the carpet exceeded the Hylands' authorized credit limit?

If the charge had exceeded the Hylands' authorized credit limit, then the bank definitely could charge back the amount of the purchase. See Jordan and Warren, at 214.

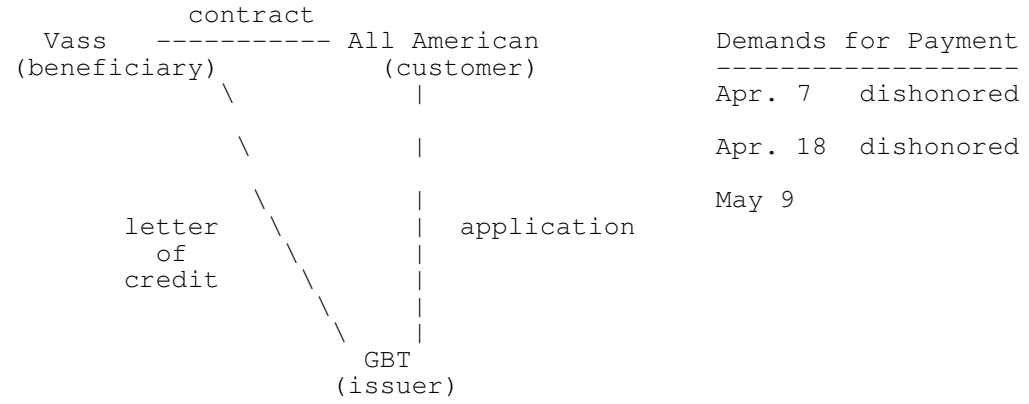
D. What advice would you have given the parties?

Evangelinos does not seem to have much reason to discontinue his practice of cheating tourists.

The Hylands should take steps to insure that merchants located more than 100 miles from their home do not defraud them, because they may not have the simple remedy of asserting a defense against the issuer of their credit card. They should seek to make a contract with the bank requiring the bank to assume defenses.

The Bank should have told the Hylands that any problem with the carpet was their problem.

PROBLEM VII.



A. Should GBT have relied on All American's instruction in refusing to pay Vass's April 18th draft?

No. It must determine whether to pay based on the documents presented. See 5-108(a).

B. What rights would GBT have it had paid Vass's April 18th draft?
GBT would not have had a right to reimbursement because Vass did not make the required certification and therefore not all of the terms of the letter of credit were satisfied. See 5-108(i).

GBT would a right to recover the mistaken payment from Vass under a theory of restitution.

GBT also might be subrogated the Sheriff's rights under the unpaid invoices, and presumably could enforce those against All American. See 5-117(a).

C. What action should GBT take with respect to the May 9th presentation if it does not understand the meaning of the phrase "subject to a claim made accruing prior to that date" in the letter of credit?

The bank must observe "standard practice" in deciding whether to honor the letter of credit. See 5-108(a), (e). Expert testimony would reveal whether a bank, when faced with such ambiguity, would have to dishonor the draft or instead could seek clarification from the parties.
The bank should disregard non-documentary terms. See 5-108(g).
D. If GBT does not honor the May 9th presentation, what rights will Vass have?

If GBT properly dishonors the letter, Vass will no rights against GBT because the letter of credit will have expired.

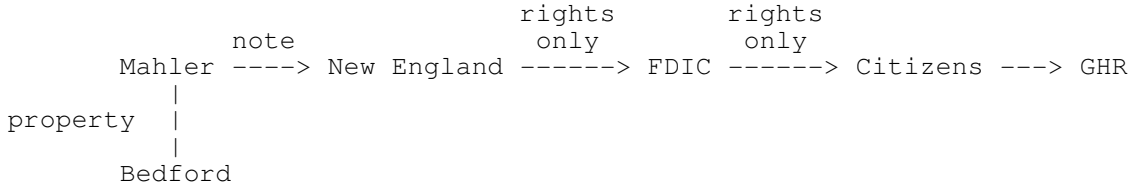
If GBT wrongfully had dishonored, then Vass would have a claim for payment. See 5-108(a).

Vass may recover from All American for outstanding bail bond debts. A standby letter of credit usually is used only as form of guaranty, and does not discharge the underlying obligation unless otherwise agreed. See 5-103(d).

December 19, 1996
COMMERCIAL PAPER--PAYMENT SYSTEMS
Final Examination Answer Guide

PROBLEM I. (25 points)

New England Savings Bank v. Bedford Realty



A. Can GHR be sure that it took its interest in the note from competing claims of ownership?

Not entirely. Although Reid states that the note is missing, New England in fact may have sold the note to someone else.

GHR, Citizens, and the FDIC are not holders because they never had possession of note. See 1-201(20). They therefore cannot be holders in due course. See 3-302(a). As such, they did not take their interest in the note free of competing claims of ownership. See 3-306.

Note: The Federal Holder in Due Course Doctrine cannot apply if the FDIC never takes possession of the note.

B. Is GHR entitled to enforce the note against Mahler?

Probably yes. New England had the right to enforce the note as a loser. See 3-309(a). New England presumably could assign that right to someone else, although the article 3 does not say so explicitly.

C. If Mahler does not pay the note, does GHR have any rights against Citizens or the FDIC?

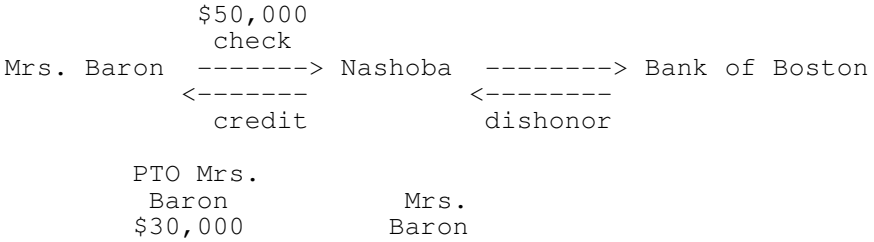
No. The FDIC and Citizens do not have indorser liability because they did not indorse the note. See 3-415(a). They did not transfer the note because they did not deliver it. See 3-203(a). Accordingly, they did not make transfer warranties. See 3-416(a).

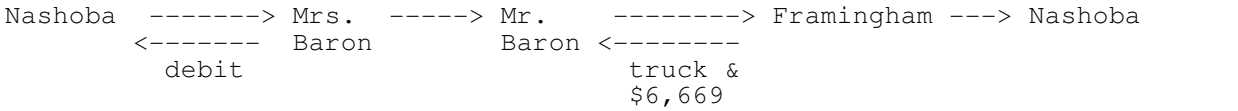
D. Does Bedford have any liability on the note?

No. Bedford did not sign the note. Bedford therefore did not assume liability on it. See 3-401.

PROBLEM II. (25 points)

Framingham Auto Sales, Inc. v. Workers' Credit Union





A. Could Nashoba have refused to allow Mrs. Baron to withdraw $30,000 from her account to pay for the cashier's check?

Nashoba did not have to give Mrs. Baron more than, at most, $5,000 credit for the $50,000 check that she deposited. See 12 C.F.R. 229.13(b). If it had not yet given her the credit, it could have refused to allow her to pay for check with a debit to her account.

However, if Nashoba already had given her $30,000 credit, Nashoba had no right to revoke the settlement until the Bank of Boston dishonored the check. See 4-214(a).

B. What rights did Nashoba have against Mrs. Baron upon learning that the $50,000 check was dishonored?

Upon dishonor, Nashoba had a right to revoke and recover any credit that it had given to her ($30,000 - $100) even if that credit had been withdrawn. See 4-214(a). It also could enforce the check against her.
C. What claims may Framingham assert against Mr. and Mrs. Baron under article 3?

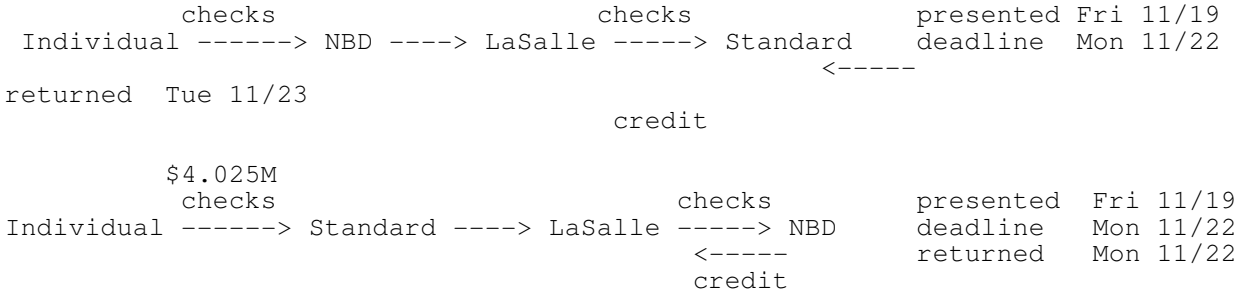
Framingham has a claim against Mr. Baron for breach of the transfer warranty that the instrument was not subject to any defenses. See 3-416(a)(4).
It was subject to the defense of failure of consideration.
Framingham has a claim against Mrs. Baron because she indorsed the instrument which the drawee, Nashoba, dishonored. See 3-415(a).
Note: Mr. Baron did not indorse the instrument and therefore has no indorser liability. See 3-415(a). Mrs. Baron did not make any transfer warranties because she did not transfer the instrument for consideration. See 3-416(a).

D. To what is extent is Nashoba liable to Framingham?

Nashoba must pay the $30,000 check to Framingham because it is a holder in due course and thus not subject to defenses. See 3-305. Nashoba also must compensate Framingham for expenses and loss of interest. See 3-411(b). There is no evidence of consequential damages.

PROBLEM III. (25 points)

NBD Bank v. Standard Bank & Trust Co.



A. Did NBD or Standard become accountable for the checks?

NBD did not become accountable for the 4.025 million in checks because it returned them before its midnight deadline, Monday, November 22. See 3-302(a).

Standard, which had the same deadline, became accountable for the $3.997 million in checks because it returned the checks on Tuesday, November 23. See id.

Note that 12 C.F.R. 229.30(c) conceivably could have extended the midnight deadline for Standard, but no facts indicate that it did.
B. Assume that Standard mistakenly had failed to return the checks and that, as a result, NBD had given the individual credit for their full amount.
1. What rights would Standard have against the individual?
Standard could charge the individual's account even though payment would create an overdraft. See 4-401(a).

2. What rights would Standard have against NBD?

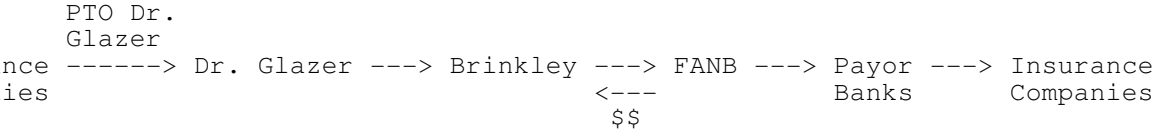
Although state law sometimes gives a payor bank a right to recover a mistaken payment in under a theory of restitution, Standard cannot recover from NBD because it "took the instrument in good faith and for value." See 3-418(b),
(c). NBD gave the individual value because it gave the individual credit and could not revoke this credit once it had received final settlement. See 4-211; 4-210(a)(2); 4-214(a).

3. Could NBD revoke the credit given to the individual?

No. Again, NBD could not revoke the credit once it received final settlement for the checks. See 2-214(a).

PROBLEM IV. (25 points)

Glazer v. First American National Bank



A. May Dr. Glazer recover from the insurance companies that wrote the checks?

No. The underlying obligations of the insurance companies were suspended when Dr. Glazer took their checks. See 3-310(b)(1).
B. Did FANB convert any of the checks by cashing them?

FANB did not convert any of the checks. A bank converts checks if it takes them "by transfer, other than through a negotiation, by a person not entitled to enforce." See 3-420(a).

FANB took that checks that Brinkley indorsed through a negotiation because, as an employee entrusted with responsibility, her signature was effective as Dr. Glazer's indorsement. See 3-405(b).

FANB became a holder of the checks that Brinkley did not indorse because Dr. Glazer had an account at FANB. See 4-205. Because it became a holder, the transfers were negotiations. See 3-201(a).
Note that the 4-205 takes precedence over the first sentence of 3-201(b), which says that negotiation requires an indorsement.

C. If Dr. Glazer could show that FANB failed to exercise ordinary care, how would that help him?

Dr. Glazer could recover from FANB on the checks that FANB signed "to the extent the failure to exercise ordinary care contributed to the loss." See 3-405(b). In this case, the bank arguably failed to exercise ordinary care when it did not inquire about Brinkley's authority to cash the checks.
D. What should Dr. Glazer have done to prevent this type of fraud?
Dr. Glazer had a number of options. Here are some examples:
Most importantly, he should not have entrusted an untrustworthy person with responsibility over the checks.

He could have bought fidelity insurance.

He could have made an agreement with his bank prohibiting the cashing of his business checks.

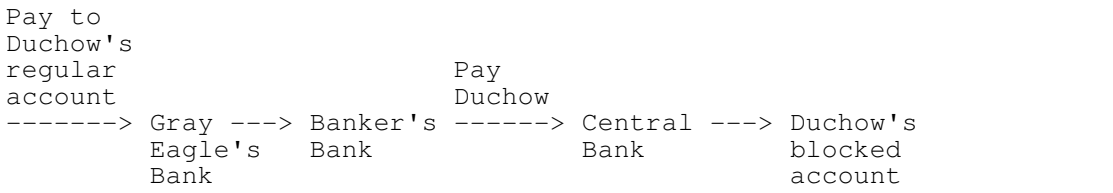
He could have hired an outside auditor.

He could have modifyied the computer program to prevent deletion of patient records.

He could have required all checks to be stamped "for deposit only" immediately upon their arrival.

PROBLEM V. (25 Points)

General Electric Capital Corporation v. Central Bank



A. Did Banker's Bank have a duty to transmit the entire instructions, including the number of the blocked account?
Gray Eagle's bank complied with its duties by sending a correct order to Banker's Bank. See 4A-302(a)(1).

Banker's Bank did not comply with its duties because it failed to instruct Central Bank according to Gray Eagle's instructions. See 4A-302(a)(1).
Central Bank arguably complied with its duties. If a beneficiary's bank accepts a payment order, it has a duty to pay the beneficiary. See 4A-404(a). A beneficiary's bank pays the beneficiary if it credits "an account" of the beneficiary. See 4A-405(b). Central Bank did credit "an account," and had no reason to suspect that it was the wrong account.

Note: It is possible that Central Bank had no duty to pay. Perhaps no acceptance of the order could occur because the order did not contain sufficient identifying information. See 4A-207(a).

B. If Gray Eagle has paid its bank for the payment order, does it have right to a refund under article 4A?

Probably yes. The originator ordinarily has a duty to pay its bank when its bank accepts the payment order, which Gray Eagle's bank did. See 4A-402(b).
Gray Eagle's duty arguably was excused when Banker's Bank executed an erroneous payment order. See 4A-303(c); 4A-402(c). One difficulty is that

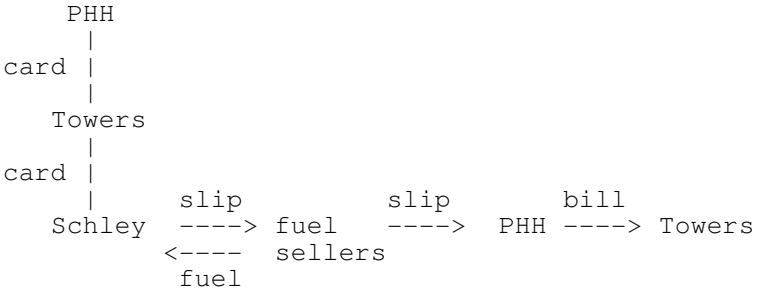
the payment did reach the correct beneficiary, though the wrong account.
C. If Banker's Bank had included the number of the blocked account, could Central Bank still have chosen to look only at Duchow's name when paying the ordermaking the credit?

No. It is true that Banker's Bank did not exercise ordinary care. Perhaps Central Bank should have inquired about the account number. But if the money had ended up in the correct account, the failure of the banks to exercise ordinary care would not have caused any injury. Moreover, some courts have held that Article 4A generally precludes action for negligence because they would be inconsistent with its provisions. See 4A-102 cmt.
D. If Banker's Bank informs Central Bank of the error, may Central Bank debit the blocked account and credit the regular account?

Ordinarily a payment order cannot be canceled after it is accepted. See 4A-211(c). But Central Bank may agree to allow Banker's Bank to cancel/amend the payment order because of the misidentification of the beneficiary. See 4A-211(c)(2). Central Bank then could recover from the beneficiary in restitution. See id. But would a court grant restitution to remedy an unsuccessful fraudulent scheme?

PROBLEM VI. (25 Points)

Towers World Airways v. PHH Aviation Systems



A. What is Towers's liability for the purchase of fuel in connection with chartered flights?

Towers has to pay for all of the charges, whether for chartered or non-chartered
flights, because Schley had apparent authority to make them. See C.C.P.A. 103(o); Walker Bank. He had apparent authority because it was the custom to entrust pilots with cards and there was no way to distinguish the charter flights from non-charter flights.

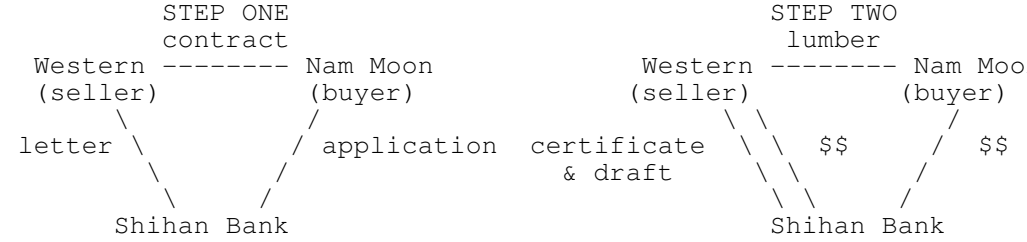
Note: The CCPA applies to business credit cards. See CCPA 135.
B. If Towers had informed PHH prior to cancellation that Schley did not have permission to use the card to purchase fuel for chartered flights, would that make a difference?

No. Notification to the issuer does not suffice to deprive the cardholder of apparent authority to use the card. See Walker Bank.
C. What measures could Towers have taken to protect itself?
PHH should not have entrusted the card to someone who was not trustworthy. Alternatively, it should have given the card to use only during non-chartered flights, and taken it away from him at other times.
D. An additional fact, not mentioned above, is that the card was "inscribed with the registration number" of the leased jet. Would Towers be liable for purchases of fuel by Schley for other jets?

Maybe not. The registration number might have indicated that he lacked authority to make purchases for other jets. We would have to know more about industry custom to answer this question for sure. See Gulf Refining Co. v. Williams Roofing (cited in Sears, Roebuck & Co. v. Duke on page 200 of the case book). Perhaps the merchants do not look at these inscriptions.

PROBLEM VII. (25 Points)

Western International Forest Products, Inc. v. Shihan Bank



A. Why would Western request Nam Moon to pay for the lumber with a letter of credit?

Western wanted to be sure that, if it shipped the lumber all the way to Korea, it would receive payment for it. See textbook, p. 359.

B. What rights would Shihan Bank have if it properly honors a presentation and makes payment under the letter of credit?

Shihan would have a right to reimbursement from Nam Moon. See 5-108(i)(1).

C. Must Shihan bank honor the faxed certificate of inspection?

An issuer of a letter of credit must honor a presentation that "as determined by standard practice ... appears on its face to comply with the letter." See 5-108(a). Standard practice refers to the custom of financial institutions. See 5-108(e). The question would be whether banks customarily honor faxed certificates of inspection or, instead, require originals.

D. What other document, besides a certification of inspection, is the letter of credit likely to have required Western to present?

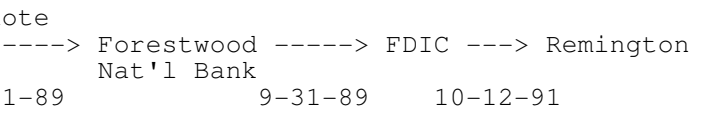
The letter of credit probably also required Western to present a bill of lading showing shipment of the goods from Alaska to Korea. See textbook, p. 359.

After presenting the billing of lading, Western could draw on the letter of credit with a sight draft.

December 19, 1995
COMMERCIAL PAPER--PAYMENT SYSTEMS
Final Exam Answer Guide

PROBLEM I. (25 points)

Bailey, Vaught, Robertson v. Remington Investments



maturity = 4-11-90

A. What indorsements would Remington need in order to have the rights of a holder in due course?

None. Under the FDIC holder in due course doctrine, the FDIC became a holder in due course even though it took the notes in a bulk sale. See Campbell Leasing v. FDIC; 3-302(c) cmt. 5, 3;. The FDIC could transfer those rights to Remington without indorsement. See 3-203(a).

B. How are Remington's rights affected by the maturity date of the note and the ambiguity about the interest rate?

The ambiguity about the interest rate does not prevent Remington from being a holder in due course. Section 3-112(b) indicates that interest should be paid at the judgment rate.

The maturity date does not prevent Remington from being a holder in due course. The FDIC became a holder in due course before the notes became due, and transferred its rights to Remington.

C. How would the rights of a holder in due course help (or not help) Remington in its action against BVR?

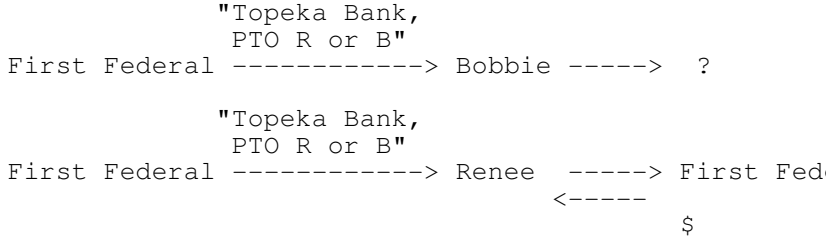
Remington would be subject to the usury defense because usury is a real defense. See 3-305(a)(ii) & cmt. 1, 4. Remington is not subject to the setoff defense because setoff is an ordinary defense. See 3-305(a)(ii) & 3-305(b).

D. What rights, if any, does BVR have against the FDIC?

BVR must submit a claim for the certificate of deposit to the FDIC in its capacity as the receiver of Forestwood. See Campbell Leasing v. FDIC.

PROBLEM II. (25 points)

Steenbergen v. First Federal Savings & Loan of Chickasha



A. Did First Federal have a right to stop payment on the check that it issued to Bobbie?

Yes. The first check was a teller's check. See 3-104(h). First Federal was the drawer and the Topeka Bank was the drawee. The drawer has right to stop payment. See 4-403(a).

B. May Bobbie enforce her check against First Federal?

Yes. Bobbie is the holder of the check because she is in possession and the check is payable to her order. See 1-201(20); 3-310. Because she is a holder, she is entitled to enforce. See 3-301.

Related observations:

Bobbie may recover damages and costs from First Federal for wrongfully stopping payment and refusing to pay the teller's check. See 3-411(b). First Federal did not discharge its liability by stopping payment. See 3-414(b).

First Federal also did not discharge its liability by paying Renee. Only payment to a person entitled to enforce discharges the drawer. See 3-602(a). Bobbie was not entitled to enforce; she was not a holder because she
did not have possession. See 1-201(20).

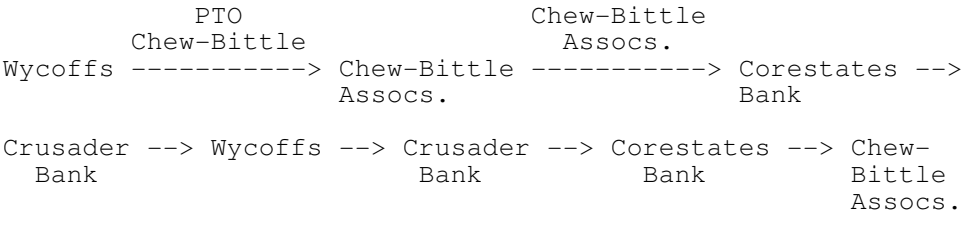
C. May Bobbie recover from anyone under a theory of conversion?
No. No one has converted Bobbie's check. No one stole the check or paid it because it remained in her lock box. See 3-420.

D. What rights, if any, do Renee and First Federal have with respect to each other?

First Federal may have a right to restitution because it gave Renee a check by mistake. Renee, however, may have a defense. The facts say that she used the proceeds to her benefit. Detrimental reliance may preclude recovery in restitution. Cf. Banque Worms v. Bank America.

PROBLEM III. (30 Points)

Chew-Bittel Assocs. v. Crusader Savings Bank



A. How should the check have been indorsed?

The check was payable to Chew-Bittle, but the holder's name was "Chew Bittle Associates." Crusader Bank could require Chew-Bittle Associates to indorse the check using both names. See 3-204(d). The depositary bank, however, would become a holder even without indorsement. See 4-205.
B. Did Crusader Bank have a right to return the check to Corestates Bank on March 2, 1992?

No. Crusader Bank had a right to return the item only until midnight after the day it received it. See 4-301(a). It waited several weeks.
C. When Corestates Bank received the returned check, did it have a right to debit Chew-Bittle's account?

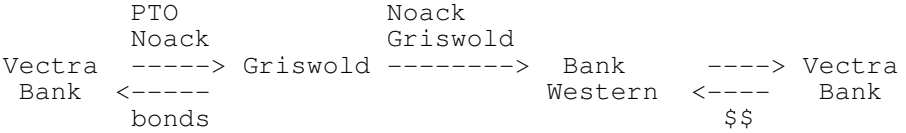
No. Correstates Bank had a right to charge-back any credit that it gave Chew-Bittle for the check. 4-214(a). This right, however, became terminated when Corestates received final settlement from Crusader Bank. See 4-214(a) (last sentence). Final payment occurred when Crusader failed to return the check by its midnight deadline. See 4-215(a)(3).

D. What rights does Chew-Bittle have against the Wycoffs?
Chew-Bittle cannot recover on the check because the check has been paid. See 4-215(a)(3). [To the extent that Corestates has debited its account, Chew-Bittle has a right against Corestates.]

Whether Chew-Bittle can recover from the Wycoffs under the original contract depends on whether the Wycoffs executed an accord and satisfication. Crossing out the language on the check had not effect. See 1-207(2). The issue will be whether the debt was subject to a bona fide dispute and the Wycoffs acted in good faith. See 3-311(a).

PROBLEM IV. (25 Points)

Vectra Bank v. Bank Western



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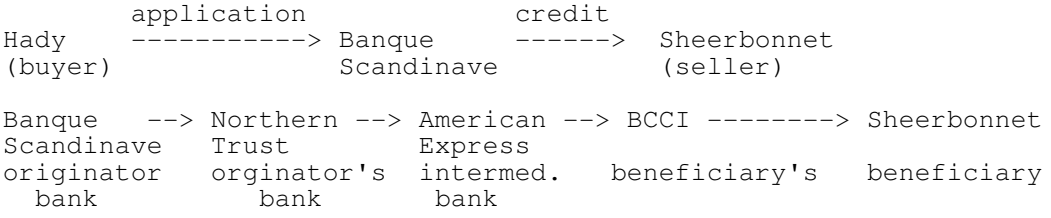
PROBLEM V. (30 Points)

Sheerbonnet v. American Express Bank



A. Does Sheerbonnet have any rights against Hady?

None. Hady complied with the sales contract by arranging for payment by a letter of credit.

B. Does Sheerbonnet have any rights against any bank under Article 4A?

Sheerbonnet, as the beneficiary, has a right to payment from BCCI. BCCI accepted the payment order by receiving payment from American Express. See 4A-209(b)(2). Once the beneficiary's bank has received payment, it has a duty to pay the beneficiary. See 4A-404(a). In this case, however, the right to collect from BCCI is not worth much because regulators have frozen the BCCI's assets.

C. Would article 4A preclude Sheerbonnet from recovering from AEB on a theory of common law negligence?

Unclear. The drafters of article 4A have suggested that courts should not supplement its provisions with inconsistent common law duties. See 4A-102 cmt.

American Express would argue that liability will impose a duty on intermediate banks to check the status of beneficiary banks. That would be inconsistent with the automatic nature of payment.

Sheerbonnet will argue that article 4A does not address this particular question. It also will argue that the payment system needs to prevent negligence.

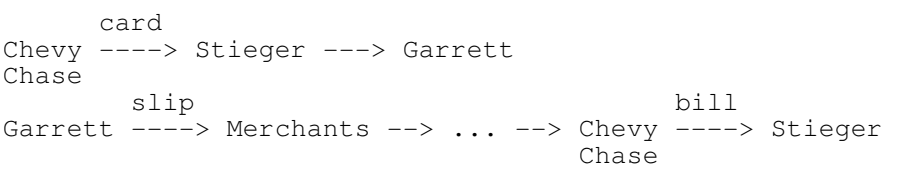
D. Does Banque Scandinave have any rights against anyone?

Banque Scandinave, having honored the letter of credit, has a right to reimbursement from Hady for $12.4 million. See 5-114(3).

Banque Scandinave does not have the right to reimbursement from any bank because its duty to pay was not excused. See 4A-402(d). The obligation of a sender to pay is excused only if the beneficiary's bank does not accept. See 4A-402(c) (last sentences). Here BCCI did accept.

PROBLEM VI. (30 Points)

Stieger v. Chevy Chase Savings Bank



A. Which charges were authorized and which were unauthorized?
The charges that are unauthorized are those for which Garrett had neither express nor apparent authority. See CCPA 103(o).

She had actual authority for the rental car and hotel charges because Stieger granted her that authority. Whether she had apparent authority for the other charges depends on whose perspective the court considers. See Walker Bank v. Jones.

From the merchant's perspective, she had apparent authority for all of the charges she signed as P. Stieger because that was the name on the card. How she might have had apparent authority for the charges that she signed in her own name is unclear. (Is possession of the card enough? If so, then why wouldn't a thief have apparent authority?)

From the bank's perspective, how would she have apparent authority for any of the charges? The bank never knew she had the card.
B. To what extent is Stieger liable to Chevy Chase for the authorized charges?

Stieger is liable to Chevy Chase for the full amount of authorized charges, unless he has a defense against the merchant that he may assert against Chevy Chase. See CCPA 170.

C. To what extent is Stieger liable to Chevy Chase for the unauthorized charges?

$50. See CCPA 133(a)(1)(B).

D. Would it make a difference if Stieger never had signed the back of his card?

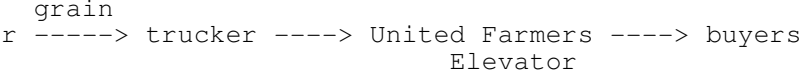
A cardholder is only liable for unauthorized charges if the credit card is

an "accepted card." See CCPA 133(a)(1)(A).

An "accepted card" is a card that the cardholder has "requested and received or has signed or has used, or authorized another to use." See CCPA 103(l). Stieger appears to have accepted the card by using it or authorizing it to be used, whether or not he signed it.

PROBLEM VII. (20 Points)

Schluter v. United Farmers Elevator



A. What rights, if any, do the farmers have?

The Farmers have a right to recover the sales price of the grain from the trucker. That is not a very useful right, however, because the trucker is bankrupt.

B. Why did the grain elevator not issue a warehouse receipt to the trucker?

It did not issue a warehouse receipt because it was purchasing the grain, not merely storing. If it had issued a warehouse receipt, the trucker would still own the grain.

C. How might the parties have structured this transaction to reduce the risk of nonpayment?

The Farmers should not have sold the grain to the trucker on credit unless they could be sure he would pay. If they wanted to sell the grain to the farmer, they either should have made him pay in cash or obtained some kind of security, like a guarantee or standby letter of credit.
The Farmers could have paid the trucker to carry the grain and obtained a bill of lading for it. They then would have retained title to the grain. They could have exchanged the bill of lading for payment from United Farmers.
D. When the grain elevator sold the grain, could it pass title simply by issuing a warehouse receipt to the buyer?

Yes. The warehouse owned the grain. It could pass title by issuing a warehouse receipt for it.