

## Answers

1.

The issue is whether Penn Circle can dishonor Billy Bob's check. There are two possibilities for PC to dishonor. The first is to dishonor in accordance with Billy Bob's stop payment order; the second is to dishonor for insufficient funds.

Under 4-403 a customer has a right to order its bank not to pay an item, if it does before the bank is prevented from dishonoring the item. Under 4-303(a), a stop payment order comes too late if it arrives (5) after the close of business on the banking day after the day on which the check was received [or (4) after the bank has become accountable for the item pursuant to 4-302]. It may be too late for Penn Circle to honor Billy Bob's stop payment order. The \$35,000 check was presented for payment by the collecting bank on Tuesday. Pursuant to 4-403(5) [or 4-302], PC had until the close of business on Wednesday [or until midnight on Wednesday] to comply with the stop payment order to dishonor the check and did not do so.

However, Penn Circle may dishonor the check for insufficient funds. Under 4-302, ordinarily a bank must dishonor a check by its midnight deadline or be deemed to have "finally paid" the check, that is, become accountable for it. However, Reg CC 229.30(c) gives the bank an extra day to return the check, provided it does so before the close of the next business day. Thus, while ordinarily PC would have been deemed to have paid the check by midnight on Wednesday, it may still dishonor the check if it returns the check to the Bank of Ogden before the close of business on Thursday. Thus, PC should return the check to Bank of Ogden by means of a private courier service before the close of business on Thursday.

2.

The issue is whether and to what extent First Lender can recover from B, an accommodation maker, on a \$10,000 note. Under 3-605(c), when the obligee agrees to an extension of the due date without an accommodation party's consent (3-605(i)), the extension discharges the accommodation party to the extent that the accommodation party proves that the extension caused a loss. Here, First Lender agreed to the extension without getting B's consent. Moreover, the extension caused a loss to B, because on the original due date A had assets worth \$8,000 but by the date of the extended due date those assets were worth only \$3,000. On the original due date, B would have been liable for \$2,000, while on the extended due date it would be liable for \$7,000, resulting in a loss of \$5,000. Thus B would be discharged to that extent.

However, there is a further issue relating to the transfer to Second Lender and back to First Lender. Under 3-605(h) an accommodation party is not discharged vis-a-vis a party who took without knowledge of the discharge. Under 3-419(c), a party is presumed to be an accommodation party if they sign as an anomalous indorser or with words of guarantee. Because Second Lender took without actual knowledge of B's status, and because B's signature did not give presumptive notice (B signed as a co-maker and did not include words of guarantee), B is not discharged as against Second Lender.

Moreover, pursuant to the shelter rule, 3-203, when Second Lender transferred the note back to First Lender (who did have actual knowledge of B's status) First Lender acquired all the rights of Second Lender. Because First Lender did not engage in any fraud or illegality with regard to the note, First Lender will be able to enforce the note against B to the extent Second Lender could, which would be in the full amount of \$10,000. (The analysis would be the same if one used the holder in due course doctrine, 3-302, 3-305, and 3-601.)

3.

A. The issue is what causes of action Employee has when a check payable to her is stolen, the restrictive indorsement is fraudulently canceled, and the check is cashed.

Pursuant to 3-206(c), when a check is indorsed with the words “for deposit,” it is converted if a person other than a bank purchases the check or if a depository bank takes the check for collection, unless the funds end up in the right person’s hands. Because Employee indorsed the check “for deposit” and did not authorize those words being stricken and did not end up with the funds, Employee could sue either the currency exchange or Near West for conversion.

B. Assuming Employee sues Near West, she should recover the amount of the check in an action for conversion. The issue then becomes whether Near West can shift the loss back up the chain of negotiation. This will depend upon whether the currency exchange violated any transfer warranties when it deposited the check with Near West.

Under the transfer warranties of 4-207(a)(3) (which applies because the check entered the bank collection system), the currency exchange warranted that the check had not been altered. Under 3-407, an alteration is any “unauthorized change” that “purports to modify in any respect the obligation of a party.” Arguably, the unauthorized striking of the restriction from the indorsement modified the obligations of later transferees because it allowed them to take free of the restriction. Thus, Near West could argue that the currency exchange violated the transfer warranty of no alterations. If successful this would shift the loss to the currency exchange, and because the thief cannot be found the currency exchange would be the “ultimate stuckee.”

4.

The issue is whether Tru-Form, its bank or the depository bank, which is Local Bank, will bear the loss caused by Emily’s embezzlement. Under 3-405, when an employer “entrusted an employee with respect to the instrument” and the employee forges the indorsement of a payee of the employer’s check, the forged indorsement is nevertheless effective. Responsibility is defined to include the authority to “prepare instruments for issue in the name of the employer.” Emily’s job is to prepare the checks for signature by the VP, so it appears she would fall within that definition. Because her forged indorsement in the name of LI is effective, the checks were properly payable from TF’s account, so the employer cannot demand that they be recredited. (It also means that Local Bank breached no presentment warranties when it forwarded the checks for collection.)

There is perhaps an argument that the two checks should be considered differently. There was no fraudulent intent in the preparation of the first duplicate check, the one for \$4,000. However, there was a fraudulent intent at the time Emily deposited the first check, so there was a fraudulent indorsement. This is similar to the situation outlined in Case # 6 in Official Comment 3 to 3-405, where the officer’s fraudulent intent was not present at the time the check was drawn but was present by the time the indorsement was forged.

5.

The issue is whether the note is negotiable. To be negotiable, a note must (1) be payable to bearer or order; (2) be signed; (3) be payable on demand or at a definite time; (4) be an unconditional promise or order; (5) to pay a fixed amount of money; and (6) not state any other promise or undertaking. 3-104(a). As to (1), this note is payable to the order of Payee,

presumably an identified person. It contains the “magic “ words of negotiability: to the order of. See 3-109. As to (2), the note is signed by X. There might be an issue as to (3), whether the note, which states that it is payable on the last day of exams, is payable at a definite time. Section 3-108 states that a note is payable at a definite time if the time is “readily ascertainable” at the time of issue; here the note was signed and presumably thus issued on January 4, 2003. At that time the last day of exams was known and published, thus it should be determined to be readily ascertainable. As to (4), the promise is not made conditional by the automatic extension granted if X withdraws, as that is allowed under 3-108(b)(iv). Similarly the right of prepayment does not make the note nonnegotiable, as that is allowed by the same section. As to (5), the note is for a fixed amount even though it imposes interest at a rate that must be determined by reference to other sources, as that is allowed by 3-112(b). And finally, as to (6), the granting of a security interest and the authorization to allow Payee to seize and resell the collateral do not constitute additional promises or undertakings as they are specifically allowed by 3-104(a)(3).

6.

The first issue is whether payment operates as a discharge of Maker’s liability on the note. According to 3-602, payment operates as a discharge. Thus, Maker can raise the defense of discharge.

The second issue is whether Maker can raise that defense against Factor. The defense of discharge is not good against an HDC. 3-601, 3-305. An HDC, is a holder who takes for value, in good faith and without knowledge of the defense or claim. 3-302. It appears that Factor is an HDC. He took the note for value (\$9,500 constitutes value even though it is less than the face amount of the note because it is the entire purchase price of the note); apparently in good faith, or at least nothing in the facts suggests otherwise; and without knowledge of any defense – the note is not overdue and he does not know that it has been paid. As an HDC, Factor takes free of the defense of discharge and Maker will be obligated to him.