

Spring 1993
ADVANCED COMMERCIAL PAPER FINAL EXAMINATION

Instructions:

1. You have 3 hours (plus 15 minutes) to complete this exam. I will collect your answers in the room in which the exam is handed out at 11:45 a.m. Late bluebooks will be penalized.
2. All answers must be written in bluebooks. Please write on only one side of a page, but you do not need to double-space. Please number your answers to correspond to the question and sub-part you are answering, but you need not answer in any particular order.
3. Assume that the transaction takes place in Arkansas and that the UCC (1992 Arkansas version) applies to the transaction unless otherwise indicated.
4. You are permitted to use your copy of the UCC and relevant statutes which may have notations (such as those you have made during the semester), but may not be otherwise annotated. Any other notes or materials should be placed at the front of the room before the examination begins.
5. You are required to turn in your copy of the test along with your answers. Label both with your exam identification number. Please number your bluebooks.
6. If any ambiguity appears in any question, state the ambiguity, make your assumption, and proceed accordingly.
7. "HDC" means holder in due course. If a party is so labeled, you are entitled to assume that all the prerequisites of that status are met. If an instrument is labeled a "check" or a "note", you may assume that it meets the Article 3 requirements for that type of instrument.
8. This exam consists of the following parts, divided into subparts as indicated. Please budget your 3 hours carefully. You should apportion it approximately as follows:

Question	Points Each Total	Time (Approx) Each Total
Part I. A-F	12 72 21	130 Min.
Part II. G-H	8 16 14	28 Min.
Part III. Short Answer	12	22 Min
TOTAL	100	180 Min.

PART I. (12 Points Each, Approx. 21 Minutes Each)

A. Hayes (who was 65 years of age) wanted to buy a houseboat. He planned to use it for recreation, but to rent it out for income on summer weekends. He therefore contacted Garfield Boat Sales, which quoted him a price on the relevant boat of \$40,000 in cash or \$44,000 if paid in one year. The relevant Federal Reserve discount rate was 5%. Garfield stated that in view of Hayes' age, Garfield would further require both credit life insurance (to be purchased from Garfield at a cost of \$350) and a second mortgage on Hayes' current residence if Hayes selected the time price option. When Hayes hesitated, Garfield agreed to keep the price terms open for a period of 30 days for a fee of \$20, which Hayes paid.

At the end of the 30 days, Hayes entered into the transaction. The disclosure documents indicated a Finance Charge of - \$4000 and an Amount Financed of \$40,000. Hayes executed the sales contract, a second mortgage on his home, and paid the premium for the credit life insurance. Thirty days have now passed, and Hayes fears he will not be able to pay at the end of the year and will lose his home. Advise him as to any legal rights he may have.

B. Washington drew a \$4000 check on First National Bank to Adams Enterprises for the purchase of certain goods, which check he postdated to August 1, 1993. Adams Enterprises delivered the goods, but its endorsement as payee was forged by its employee, Jefferson. Jefferson worked as a mail clerk but was being trained as an apprentice bookkeeper for Adams Enterprises. His responsibilities included sorting through incoming checks for delivery to the bookkeeping department, observation and instruction for half the day in the bookkeeping department, and delivering the checks to the bank for deposit at the end of the day.

During the lunch hour one day, Jefferson utilized the check imprinting machinery to forge Adams Enterprises' blank endorsement on the check drawn by Washington. He then deposited the check into his own account at Second National Bank. He subsequently withdrew the proceeds and has vanished. Meanwhile, the check was presented through normal banking channels to First National Bank. Despite the fact that the check overdrafted the account by \$4,000, First National Bank paid. At this point, what are the rights of:

- 1) First National Bank against
 - a) Washington
 - b) Second National Bank.
- 2) Adams Enterprises against Washington.

C. On May 20, Roosevelt stole McKinley's checkbook and forged McKinley's signature as drawer on a \$300 check that he made payable to Roosevelt. He then indorsed the check to Taft as a birthday present. Taft thought it was a strange gift, but presented it to the drawee Bank of Bentonville, which paid the check.

The Bank of Bentonville retained the check itself, but sent a summary monthly statement of account on May 31 to McKinley identifying the check number, the amount, and the date. McKinley did not review the statement.

Roosevelt similarly forged a second \$300 check on June 20, and likewise indorsed it to Taft. Taft again presented it and received payment. (Taft has utilized the proceeds of both checks to pay his rent.) The Bank sent a similar June summary statement was received by McKinley on July 3. McKinley immediately reviewed the statement has notified the bank of the second forgery and demands that the Bank recredit his account for both forgeries. Your client is the Bank of Bentonville. What are its rights and obligations as regards:

1. McKinley.
2. Taft.
3. Roosevelt.

D. Kennedy drew a check on Farmers & Merchants (F & M) Bank to Johnson in payment for services rendered. Johnson indorsed the check "Johnson". With no fault of Johnson, the check was then stolen by Eisenhower, who deposited it into his own account at State Bank and withdrew one-half of the proceeds. State Bank presented the check to F & M on Monday, April 1.

Meanwhile, Kennedy discovered that Johnson's services had been only partially completed. He therefore telephoned F & M to stop payment of the check on April 2. However, the employee who answered the phone failed to communicate that information to the F & M bookkeeping department until April 3. On April 3, therefore, F & M returned the check to State Bank, marked "Dishonored due to Stop Order."

You represent F & M Bank. What are its rights and obligations in regard to:

- 1) Kennedy
- 2) State Bank
- 3) Johnson

E. Madison is a general contractor engaged in construction. In order to finance his current project, he arranged to borrow \$100,000 from Van Buren Bank for a period of one year. Due to his lack of creditworthiness, Madison was also required to provide a co-maker (Monroe) on the relevant note and secure it by a mortgage on Madison's office building. Madison and Monroe duly executed the note on May 1, 1992 but the bank's delay in filing the mortgage caused the mortgage to become subordinated to a \$5000 mortgage filed June 1.

The note stated that it was due and payable on May 1, 1993. The parties understood that the funds were to be utilized to pay subcontractors, and were therefore deposited into a

checking account at Van Buren Bank designated "Madison Construction Account -- Project XYZ".

Madison experienced financial difficulties throughout the year, and only \$20,000 remains in the construction account. A check to Harrison Subcontractor arrived at Van Buren Bank through banking channels on April 30, 1993. On May 1, at 2:50 p.m., the bank set off the remaining \$20,000 in the construction account and applied it to the \$100,000 note to Van Buren Bank. It therefore dishonored Harrison Subcontractor's check for insufficient funds. Harrison has since contacted the prosecutor's office, which is in the process of prosecuting Madison on hot check charges.

Madison has just received a notice of default and intention to sell his office building (without a court proceeding) from Van Buren Bank. The Bank has further made demand upon Monroe for payment of \$80,000. What are the rights and obligations of each of these three parties in regard to Van Buren Bank?

- 1) Madison
- 2) Monroe
- 3) Harrison Subcontractor

F. Carter drew a check on First Bank for \$100 payable to Ford. Ford fraudulently raised the amount of the check to \$1000, indorsed it, took it to Second Bank for deposit, and inquired whether he could withdraw the proceeds prior to collection. Second Bank indicated that it would permit immediate withdrawal only if Ford acquired the additional endorsement of Rob Walton. Ford therefore persuaded Rob Walton to add his endorsement to the check, to which Walton further added "Collection Guaranteed." Second Bank permitted Ford to withdraw \$1000.

The check was then presented by Second Bank through banking channels to First Bank (a local bank) on Monday, March 1. On that same day, First Bank dishonored the check due to insufficient funds. It returned the check by means of a method of - `return` designed to `return` the check to Second Bank by Friday- March 5. However, on Thursday, March - 4, Ford filed for bankruptcy. The dishonored check arrived at Second Bank on Friday, March 5.

On Tuesday, March 9, Second Bank notified Walton and Carter of the dishonor and has made demand for payment. Discuss Second Bank's rights against and any potential defenses of the following parties:

- 1) Carter
- 2) Walton
- 3) First Bank

Part II. A Little Shorter (8 Points Each, 14 Minutes Each)

G. Truman, a Fayetteville resident, applied to Northwest Bank for a bank credit card for his personal use. Northwest Bank therefore contacted Hoover Investigations to conduct interviews with persons familiar with Truman's personal habits and creditworthiness. Based on that information but without advising Truman, Northwest Bank placed Truman in a high risk category and increased the interest rate to be charged on his account balance by .5%. The card was thereafter issued.

Although the card was issued solely in Truman's name, Truman initially designated his son Truman Junior (junior) as an authorized signatory on the account. However, six months later he notified Northwest Bank that Junior was no longer authorized to use the card. Nevertheless, Junior utilized the card to purchase \$2000 worth of scuba gear from Scuba, Inc. in Little Rock. The gear upon arrival proved to be worthless junk but Scuba, Inc. refuses to refund the money.

Discuss Truman's rights and obligations in regard to the above transactions as against Northwest Bank.

H. At the request of its customer, Clinton, Fayetteville State Bank has established a letter of credit in favor of Bush Enterprises in connection with the sale of certain goods by Bush Enterprises to Clinton. The letter of credit calls for the Bank to pay a sight draft drawn by Bush Enterprises on Fayetteville State Bank on presentation of certain documents. These include a bill of lading to be issued by "Air Freight Corporation." The letter of credit expires on May 1, 1993.

Bush and Clinton are currently involved in a dispute on the underlying contract. The relevant draft was presented to Fayetteville State Bank by Bush's agent on April 29. The accompanying bill of lading, however, reflected shipment by "Air rate, Inc. 11 First State Bank thinks that the document substantially complies with the requirements of the letter of credit, but Clinton has refused to waive any discrepancy.

Advise First State Bank as to its options and potential liability on the draft, the letter of credit, and its agreement with Clinton.

Part III. Short Answer (12 points)

1 . Explain the \$50/\$500/unlimited liability structure of the Electronic Fund Transfer Act. (2 points)

2. Define: (4 points)

- a) overencoding
- b) trade acceptance
- c) MICR fraud
- d) Discounted interest

3. Can you stop payment on the following: (Explain your conclusion):
(4 points)

- a) teller's check
- b) Electronic fund transfer
- c) Personal money order
- d) Certified check.

4. Is the depository bank liable to the drawer for paying on a forged endorsement? Why did the new version of Article 3 adopt this approach? (2 points)