

Spring 1992  
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. No late bluebooks will be accepted.
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 you have made during the semester, but may not be otherwise annotated. You are not permitted to have any other notes or materials with you.
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	Time
Part I (A-E)	70(14 pt. each)	125 min (25 min. each)
II (A-B)	16 (8 pt. each)	30 min.(15 min. each)
III	14	25 min.
TOTAL	100	180 min.
PART I. each)	70 Points (14 points each)	125 minutes (25 minutes

A. Madison wanted to borrow \$50,000 in Arkansas from Third National Bank in order to finance the purchase of a lake cabin as a weekend retreat for his family. For a commitment fee of \$1000, Third National Bank agreed to make the funds available to him for a thirty day period. A letter committing Third National Bank to make the loan until June 30 was received by Madison on June 1, and the closing was held June 8. Since Madison anticipated coming into an inheritance, the loan was to be repaid in one year with interest at the rate of 10 percent per annum. The disclosure documents indicated that the Amount Financed was \$50,000, the Finance Charge was \$5000, and the Annual Percentage Rate was 10%. No other disclosures were made. The relevant Federal Reserve, Discount Rate on June 8 was 5%. Madison gave a first mortgage on the cabin to secure the loan.

Third National Bank negotiated the note and assigned the mortgage to HDC. Madison did not pay the note when due, so HDC exercised its rights to statutory foreclosure and sold the cabin for \$20,000 (although its fair market value at the time of sale was \$40,000). HDC now seeks a deficiency judgment against Madison. Discuss Madison's possible defenses and affirmative remedies.

B. Lincoln, who sold antiques on commission, maintained his business account with Fayetteville State Bank. As the Bank was aware, checks were written out of the account to the antique owners after sales were concluded (less Lincoln's commission). Lincoln had written such checks over a three year period to Johnson. Johnson's administrative assistant, Grant, had from the beginning been forging Johnson's endorsements on these checks and depositing them in Grant's own account at Rogers National Bank. Grant had no authority to indorse Johnson's signature, but was merely authorized to deposit the checks for Johnson. Grant had been endorsing the checks "Pay to Grant, Johnson, Grant." One of Rogers National Bank's employees had notified her superior that there might be some question about Grant's authority, but no further action had been taken by Rogers National Bank. Grant's account is now empty. Lincoln had never looked at his bank statements over the three year period.

On May 1, one of these checks for \$1000 was presented through the local clearing house to Fayetteville State Bank. On May 2, Lincoln defaulted on a loan to Fayetteville State Bank. Despite the fact that the local banks had adopted a cutoff hour of 3:00 p.m. of the next banking day, Fayetteville Bank entered a setoff notation at 4:00 pm on May 2 against Lincoln's account. Also on May 2, Johnson discovered the scheme and notified Fayetteville State Bank of the forgery. Fayetteville State Bank therefore returned the check through the clearing house before midnight on May 2 to Rogers National Bank, indicating that it was dishonored due to insufficient funds and a forged endorsement.

You represent Rogers National Bank. What are its rights and obligations as to this check as against Fayetteville State Bank? Discuss all potential claims and defenses.

C. Nixon and Ford had a joint account at Springdale Bank. Nixon decided he wanted a catered dinner at home for himself and a friend, so he drew a check on April 1 on the

account to Eisenhower Catering for \$100. Knowing there were no funds currently in the account, Nixon postdated the check to September

1. The dinner was unacceptable, so the next morning Nixon called Springdale Bank to stop payment on the check.

Meanwhile, Eisenhower had fraudulently raised the amount of the check to \$1000 and deposited it (without endorsement) into his account at McIlroy Bank. McIlroy Bank allowed Eisenhower to withdraw the \$1000, which Eisenhower immediately spent, then declared bankruptcy on April 4. The check was presented to Springdale Bank on the evening of April 2, and the check was paid despite the fact that it overdrew the account for the entire amount of the check. Springdale Bank was not aware of the problem until April 5. At that point, what are Springdale Bank's rights to recover against:

- 1) Nixon
- 2) Ford
- 3) McIlroy Bank
- 4) Eisenhower

D. Washington applied for a business loan of \$10,000 from Adams Finance, because Adams misrepresented to him that it had the best financing rates in the area. Without notifying Washington, Adams Finance caused an investigative report to be compiled on Washington, which revealed that he was 60 years old. Because of his age, Adams Finance required that Washington provide an additional maker on the note. Therefore, both Washington and Jefferson signed as makers, with Washington adding "payment guaranteed" to his signature. To further secure the note, Washington provided a security interest in \$5,000 worth of equipment and inventory. Adams Finance did not perfect this interest. The loan was closed on April 1, 1992. The \$10,000 was received by Washington, and was to be repaid in installments over 5 years.

Washington had trouble making the payments during the first two years. Adams Finance frequently accepted late payments – some as late as two months. Finally, on April 1, 1994, Washington filed for bankruptcy and Adam's security interest in the collateral was set aside by the bankruptcy trustee.

1. What defenses would be available to Washington in a suit by Adams on the note? What affirmative causes of action might Washington have against Adams?

2. Assume that Adams had negotiated the note to HDC before Washington's bankruptcy. This HDC knew the security interest was unperfected, was unaware of the late payments, and had no prior connections to Adams. What would be the rights of this HDC against Jefferson after Washington files for bankruptcy?

E. Garfield drew a check for \$500 on First State Bank to the local tax collector, Hayes, in payment of his property taxes. Hayes indorsed and deposited the check in Walton Bank on Monday, October 1. Walton Bank's key operator erroneously MICR encoded the check for \$5000, and the check was presented to First State Bank through an intermediary bank the next day. Because there was only \$1000 in the account, (which the computer read as a \$5000 check), First State Bank's computer dishonored the check on October 2. The check itself was returned on the night of October 2 in an envelope indicating "INSF" to the intermediary bank (rather than to Walton Bank). Intermediary bank did not `return` the dishonored check to Walton Bank until October 10.

As required by Regulation CC, Walton Bank had permitted Hayes to withdraw the \$500 on Wednesday, October 3. Upon receipt of the dishonored check, however, it has made demand on Hayes for a `return` of that amount. Hayes has notified Garfield that Garfield wrote a "hot" check, has been spreading the word in the community, and is threatening to have Garfield arrested and prosecuted. Garfield is particularly angry because he deposited \$10,000 into the account on October 3, which could have covered even a \$5000 check. Discuss the legal rights of the following parties:

- 1) Garfield against First State Bank
- 2) First State Bank against Walton Bank
- 3) Walton Bank against

- a) Hayes
- b) Garfield
- c) intermediary bank

PART II. A Little Shorter ... 30 minutes (15 minutes each); 16 points (8 points each)

A. On May 1, Roosevelt unknowingly lost his payment device. The device was used by the finder for \$100 purchases every ten days for the next four months. Each purchase was on a day ending in "01", i.e., May 10, May 20, May 30 etc. through September 30. The bank making payments issued statements reflecting the unauthorized use on the last day of each month, but Roosevelt never examined them. Roosevelt discovered the device was missing on June 1, but did not notify the bank of its loss until October

1. What is Roosevelt's liability for the losses, assuming no negligence of the bank, if the device was:

- 1) A checkbook, to which checks the finder had been forging Roosevelt's name.
- 2) A credit card, to which the finder had been signing his name as authorized signatory.

3) A debit card, to which the finder had been signing his name as authorized signatory- A forger forged McKinley's signature as the drawer on a check, which the forger then issued for value to Taft. Taft indorsed the check and negotiated it for value to Coolidge. Coolidge, without endorsing, deposited the check into his account at First State Bank, which permitted Coolidge to draw out the entire amount. First State Bank then presented it for payment to the payor bank, Farmers and Merchants Bank (F & M) . F & M dishonored the check and returned it to First State Bank. At this point, what are First State Bank's rights to recover the amount of the check from:

- 1) F & M Bank
- 2) McKinley
- 3) Coolidge
- 4) Taft
- 5) the forger

PART III. SHORT ANSWER 25 minutes (14 points)

1. Does insurance sold by a creditor have to be included within the Finance Charge under the Truth in Lending Act? (1 point)

2. What is a time-price differential? Is it illegal? (1 point)

3. Payee's endorsement was forged on a \$2000 payroll check. The check was deposited into an account at the depository bank and paid by the payor bank. Can payee recover the \$2000 from each of the following? Explain your conclusion: (3 points)

- a) Drawer
- b) Depository bank
- c) Payor bank

4. Can payment be stopped on each of the following? Explain your conclusion: (4 points)

- a) Personal money order
- b) Cashier's check
- c) Electronic fund transfer
- d) Payment of sales slip by issuer of credit card.

5. In a consumer credit transaction, the creditor has determined not to extend credit after examining a credit report. The potential borrower is female. What are its obligations to the consumer at this point? (1 point)

6. Identify: (1 point)

- a) Trade acceptance

b) truncation

7. A Fayetteville manufacturer wants to ship certain goods by air freight to a buyer in Paris, but is concerned about shipping goods without prior payment. The buyer has indicated that it is willing to furnish a letter of credit from a French bank. Describe the legal relations of the parties and the documents which should be utilized to carry out this transaction. (3 points)